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Conversion Table

Metric conventions are used in this report except for textual mentions of crude oil and natural gas prices and measurements in the feature article relating to the North American natural gas industry.

1 cubic metre	=	6.29 barrels
1 cubic metre	=	35.31 cubic feet
1 litre	=	0.22 imperial gallons
1 hectare	=	2.47 acres
1 tonne	=	2,205 pounds
1 kilometre	=	0.62 miles

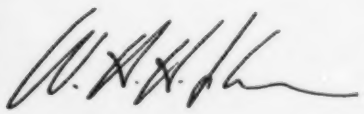
March 24, 1988

The Honourable
Marcel Masse, P.C., M.P.
Minister
Energy, Mines and Resources Canada
House of Commons
Ottawa, Ontario

Dear Minister:
On behalf of the Board of Directors, I am pleased to present Petro-Canada's Annual Report for the fiscal year ended December 31, 1987.

In accordance with the provisions of the Financial Administration Act, the Report includes the consolidated financial statements together with the auditors' report thereon.

Yours sincerely,



W. H. Hopper
Chairman of the Board
and Chief Executive Officer

The Year in Brief

- Earnings up 40 per cent
- Cash generated from operations increased 9 per cent to $778 million
- All commonly used ratios indicating financial performance and strength improved
- Oil and gas production maintained at high levels with lower operating costs
- Second phase of Wolf Lake in situ oil sands project begun
- Terra Nova delineation drilling successful
- New automotive service franchise launched
- Integration of two refineries announced
- Continued emphasis on operating efficiency including extensive computerization in wholesale and retail marketing
- Olympic Torch Relay delighted millions of Canadians, building support and customer loyalty for the Corporation

Consolidated Financial Highlights

	1987	1986
Earnings after dividends on redeemable preferred shares (millions of dollars)	172	123
Cash generated from operations (millions of dollars)	778	711
Net capital expenditures (millions of dollars)		
Property, plant and equipment	483	448
Acquisitions	—	301
Cash flow return on average capital employed (per cent)	11.3	10.7
Total assets (millions of dollars)	8 453	8 139
Shareholder's equity (millions of dollars)	3 872	3 711

Corporate Profile

Petro-Canada is Canada's national energy corporation. Formed by an Act of Parliament in 1975, it is wholly owned by the Government of Canada. Operations began on January 1, 1976. Petro-Canada operates in a commercial fashion, competing in today's oil and gas industry on the same basis as other integrated energy companies.

With assets of over $8 billion and revenue of more than $5 billion, Petro-Canada ranks eleventh in the 1987 Financial Post 500 survey of the largest industrial corporations in the country. It is also the largest Canadian-owned oil and gas company, and one of four integrated energy companies in Canada that are national in scope.

Petro-Canada is organized into two operating divisions. Petro-Canada Resources, the "upstream" business, explores for and produces crude oil, natural gas and natural gas liquids. The "downstream" business, Petro-Canada Products, refines, distributes and markets petroleum products and offers customers related goods and services.

On a typical day, Petro-Canada produces approximately 16 400 cubic metres of crude oil and field natural gas liquids and 12.3 million cubic metres of natural gas. The Corporation's straddle plants extract from pipeline natural gas an additional 6 300 cubic metres of natural gas liquids including ethane. Petro-Canada accounts for approximately 6.5 per cent of domestic oil and natural gas liquids production and about 5 per cent of domestic natural gas production. The Corporation operates more than 70 oil and gas production facilities in Western Canada.

At year-end 1987, Petro-Canada had proven reserves of crude oil and field natural gas liquids of 89.0 million cubic metres before royalties. These reserves include Petro-Canada's interests in the Syncrude and Wolf Lake oil sands projects. Proven reserves of natural gas amounted to 96.9 billion cubic metres before royalties.

Petro-Canada also has significant probable reserves off Canada's East Coast and in the oil sands areas of Alberta.

Petro-Canada holds interests in 12 crude oil, natural gas liquids and refined products pipelines. It is operator of nine pipelines with a total throughput capacity of 78 000 cubic metres per day.

The Corporation sells over 45 million litres of refined products to 650 000 Canadians each day. The Petro-Canada brand is the top-selling gasoline in the country. A nationwide network of 3 677 retail outlets serves over 20 per cent of the market. Industrial and commercial customers are served through 38 terminals and 430 bulk plants.

Petro-Canada operates five refineries in Quebec, Ontario, Alberta and British Columbia, a lubricants plant in Ontario and an asphalt plant in Saskatchewan. With about 23 per cent of total Canadian refining capacity, these facilities can process 64 000 cubic metres of crude oil per day into a full range of high-quality petroleum products.

Chairman's Message

The year 1987 brought a measured recovery in the oil and gas business. World oil prices, which averaged about U.S. $15 per barrel in 1986, rose to an average of over U.S. $19 for 1987. Higher oil prices, improved federal and provincial fiscal regimes and the cumulative impact of dozens of efficiency-seeking initiatives combined to improve Petro-Canada's financial performance. Cash generated from operations remained strong at $778 million, up 9 per cent from the previous year. Net earnings after preferred share dividends were $172 million, a jump of 40 per cent over 1986 and the highest in the Corporation's 12-year history.

Following expenditure and staffing cutbacks in response to the oil price collapse of 1986, Petro-Canada entered 1987 as a lean and tightly focused organization. Among employees, there was a clear understanding of the Corporation's overall direction. The year's results demonstrate the power of both teamwork and individual creativity. Strategies and operating plans developed during 1986 were adjusted to meet the opportunities and challenges of 1987 – firming oil prices, an upturn in refined product demand, lower prices for natural gas, and changes in taxation and royalty structures.

In upstream operations, revenue from existing assets was increased while operating costs were tightly controlled. Productivity was improved, especially in the larger, older producing properties in Western Canada.

More emphasis was placed on natural gas. Over the year the exploration, development and marketing components of the business were strengthened to take full advantage of future market opportunities.

We also developed oil sands opportunities and selectively invested in the East Coast offshore. Encouraging results from delineation drilling at the Terra Nova oilfield, off Newfoundland, led to extensive reservoir evaluation and engineering studies in anticipation of a proposal for development. Work proceeded on phased expansion of the Wolf Lake in situ oil sands plant and the Syncrude oil sands mining project.

Cash generated from operations was strong at $778 million, up 9 per cent from the previous year.

In downstream operations, our efforts to meet customer needs and secure greater brand loyalty were intensified. Across retail and wholesale networks, we unveiled or more extensively implemented a number of marketing initiatives, some of them unique to Petro-Canada. To reduce costs we announced plans to integrate two refineries in Western Canada and creatively employed computer technology in wholesale and retail operations.

Carrying out these initiatives meant an increase in capital investments in 1987 to $483 million, up 8 per cent from 1986. Investment opportunities were made more attractive by improvements in current and expected business conditions. Spending decisions differed from those taken during most of 1986, when the emphasis was on near-term cash generation. During 1987, the Corporation balanced short-term initiatives with those that would contribute to improved financial performance and corporate growth in the medium to long term.

As a result of these actions, Petro-Canada remains a strong commercial performer with excellent prospects for future growth. Our major

position in both the upstream and downstream businesses provides operational and financial synergies, while the Corporation's enviable position in oil and gas development projects in the coming years gives us unrivalled opportunities.

All of Petro-Canada's commonly used measures of financial performance and strength improved, demonstrating our commitment to sound financial management. While we look forward to the challenges which will result from decisions to proceed with frontier or oil sands developments, we recognize that Petro-Canada will require significant external financing when it embarks on such major projects.

The year ended with yet another reminder of the volatility of world oil prices. Concern in the market over the results of a mid-December meeting of OPEC ministers led to renewed price erosion, including a rapid U.S. $3 per barrel price drop. These changes did not seriously impact the Corporation's results for 1987. However, Petro-Canada will re-evaluate its plans if prices do not return to the U.S. $18 to $21 per barrel range.

Petro-Canada monitors other issues which may significantly affect its businesses, such as the free trade agreement between Canada and the United States. For the most part, the energy components of the agreement reaffirm welcome trends in both countries toward deregulation in the oil and gas industry, with reliance on open market access and price-driven competition. While the agreement probably will not lead to higher short-term oil and gas exports to the United States, we anticipate that the promise of secure access to U.S. markets will raise investment levels in the Canadian oil and gas industry in the longer term.

All of Petro-Canada's commonly used measures of financial performance and strength improved.

Changes in regulatory and fiscal arrangements bear watching. The future health of the natural gas business hinges on the continuing evolution of transportation and pricing toward market-driven principles. The development of offshore oil discoveries, such as Terra Nova, depends on the conclusion of satisfactory fiscal arrangements. The lengthy delays experienced with the Hibernia development proposal demonstrate how difficult it

is, in a low price environment, to reach agreement on the details of risk sharing.

Petro-Canada's 1986 Annual Report featured a discussion of profitability in the refining and marketing business. The point was made that, since 1981, unsatisfactory returns have made it very difficult to undertake the high, ongoing investments needed to offer the range of services and quality of products that Canadians expect. The overall situation changed very little in 1987 and the long-term vitality of Canada's refining and marketing industry remains in question. Though product demand is slightly higher and some companies have made progress in eliminating surplus refining and marketing capacity, underutilization of facilities remains a problem. In addition, marketers now have to contend with more widespread intervention by a number of provincial governments in petroleum product pricing. Controls of this nature work against the long-term interest of consumers. Over time, less vigorous competition will result as industry participants are squeezed between market-driven prices for raw materials and regulated prices for finished products.

In Canada's refining and marketing industry, underutilization of facilities remains a problem.

As 1987 ended, there were significant changes to our Board of Directors. In December, Roy Deyell and James Robertson resigned from the Board. Harrison McCain also resigned at year end, after making a major contribution to the evolution of the Corporation over a seven-year period. I would like to thank these individuals for the guidance they have provided in their capacity as directors.

The truly encouraging feature of the past year has been the significant contribution of Petro-Canada's employees. Many praiseworthy examples of individual initiative and dedicated teamwork have come to my notice. More than anything, I have been impressed by the attention many employees now give to their operating style. Although oriented to profit margins and business efficiencies, it is a style that does not contemplate sacrificing employee safety, corporate responsibility or any other component of first-rate performance.

The success of the Olympic Torch Relay is the foremost example of the teamwork that generated the recovery we are pleased to describe in this report.

Most Canadians witnessed the Olympic Torch Relay as it passed their communities. Many commented to me on the energy and friendliness shown by Petro-Canada staff along the way. More than 700 employees voluntarily assisted our small Olympic Torch Relay group in organizing and carrying out the 88-day event. Theirs is the foremost example of the teamwork that generated the recovery we are pleased to describe in this report.

W. H. Hopper
Chairman of the Board
and Chief Executive Officer
March 24, 1988

New Dynamics in Canada's Natural Gas Business

The natural gas business represents a major opportunity in the Canadian energy field. The gas industry is currently in transition, emerging from a protective yet restrictive web of regulations. While producers' revenues are disappointingly low today, reflecting weak export volumes and low prices, the outlook nonetheless appears bright. Projections for the next few years show the current gas surplus will end, leading to higher prices and greater export sales. Carefully planned investments today will let Canadian producers capture the benefits to come from market-driven prices and increased demand for Canadian gas.

Natural gas is a North American business

The Canadian natural gas industry is best viewed in a North American context. There are several reasons for this, and they hinge on the nature of the commodity. At today's prices, the only way natural gas can be transported is through pipelines. More exotic transportation options, such as liquefied natural gas shipping, are not economically feasible now or in the foreseeable future. This makes the United States the logical market for surplus Canadian supplies.

In total, there should be sufficient Canadian and U.S. supply to meet market demand in both countries in the near and medium terms. Canada's frontier gas resources will provide ample supplies in the longer term as well. For Canadian producers, sales volumes and prices will increasingly be determined more by continental supply and demand forces than by regulation.

Canada has abundant supplies

Canada has large proven and potential gas supplies in both the Western sedimentary basin and in frontier regions. Canada's remaining established gas reserves have consistently grown over the last 20 years. Our reserves life index, defined as the number of years it would take to consume current reserves at today's rate of production, has been high and stable. In 1987 Canada had roughly a 25-year supply available from established reserves of 73 trillion cubic feet (Tcf). With frontier discoveries included, the reserves reach 97 Tcf and have a life index of 36 years.

The demand for Canadian natural gas has grown consistently and was about 1.8 Tcf in 1987. Exports, which had been decreasing in recent years from about 1 Tcf in 1979 to about 750 billion cubic feet in 1986, increased to about 1 Tcf in 1987. The decreases have reflected U.S. gas surpluses, the relatively high and inflexible prices of Canadian exports, and U.S. regulatory actions which have placed Canadian gas at a competitive disadvantage.

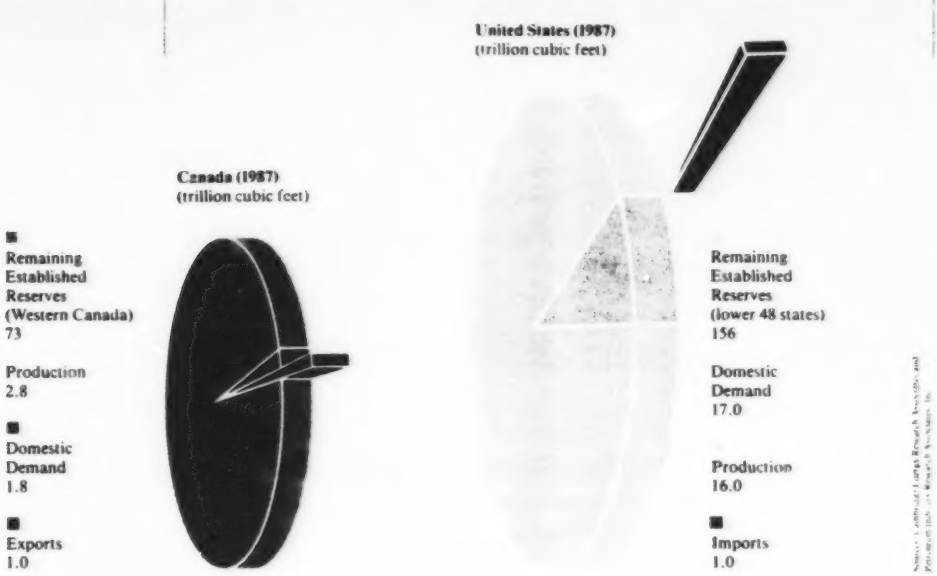
The U.S. gas market is immense

By Canadian standards, the U.S. natural gas market is very large. In 1987 consumption was about 17 Tcf, almost 10 times Canadian demand. The U.S. appetite for gas has, however, been shrinking in recent years; in 1979 it was approximately 20 Tcf. Most of the slippage has been in the industrial and electrical generation sectors. Conservation and a decline in heavy industry has reduced the size of that market, and natural gas has been displaced somewhat by low-priced residual fuel oil.

U.S. natural gas reserves are also immense, totalling about 156 Tcf in the lower 48 states. However, these reserves have declined steadily over the last 20 years as reserves additions have failed to replace production. This trend slowed with the introduction of the U.S. Natural Gas Policy Act of 1978,

Canada is fortunate to have abundant supplies of natural gas.

Estimated natural gas reserves in Western Canada will last approximately 25 years at current rates of consumption; the United States (lower 48 states) has an estimated 10-year reserves life.



which permitted some increases in U.S. wellhead gas prices. Nonetheless, the reserves life index in the United States is short, ranging between nine and 11 years since the early 1970s.

Markets opening up

In recent years, there has been more natural gas in the United States than markets can absorb. In 1987 U.S. gas wells produced 16 Tcf, though they were capable of delivering about 19 Tcf. In Canada there was a similar "deliverability surplus" of approximately 2 Tcf in 1987. As a result of these excess supplies, referred to in the United States as the "gas bubble," North American gas markets have recently been intensely competitive and prices have been depressed.

However, most observers believe the current U.S. gas surplus will dissipate over the next few years, so that domestic supplies will need to be supplemented by increased imports in the early 1990s. The decline in U.S. gas demand is expected to end. Slight demand growth could return, as new uses in the industrial and electrical generation sectors offset modest declines in gas use by traditional industrial customers. U.S. production is expected to continue to decline, particularly since current low prices discourage natural gas exploration.

Opportunities for Canadian exporters

An end to the U.S. gas surplus should have a favorable impact on Canadian gas producers, in terms of both prices and sales volumes. When available supplies more closely match demand, the price should rise to approximate the price of natural gas substitutes in the market place, primarily residual fuel oil.

The size of the U.S. gas market means even a small increase in U.S. import requirements would have a major impact on Canadian sales. Canadian exports could reach 1.5 Tcf by the early- to mid-1990s. Even with

this 50 per cent increase in sales, Canadian gas would still supply less than 10 per cent of the total U.S. market. Such an increase appears quite consistent with the availability of established Canadian supplies, given anticipated prices and expected Canadian requirements. The existing pipeline capacity can handle this level of exports, and the U.S. regulatory environment is expected to be increasingly favorable to Canadian gas imports as U.S. needs increase.

Revenues are currently depressed

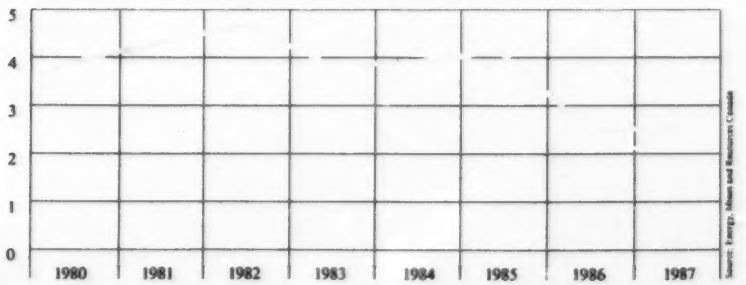
Although the future appears promising, there are a number of major challenges faced by the Canadian natural gas business. Perhaps most fundamental is planning investments for the future at a time when producer revenues are low. In 1987 gross export revenues stood at $2.6 billion, scarcely more than half the 1982 level of $4.8 billion.

The revenue drop has resulted from both lower natural gas prices and reduced export volumes. The average Canadian/U.S. border price decreased from a high of Cdn. $6 per thousand cubic feet (Mcf) in 1982 to $2.60 in 1987, a drop of over 50 per cent. Gas prices were forced down to remain competitive with cheaper oil supplies available during the 1980s. In addition, deregulation at a time of natural gas surplus led to intense competition between gas suppliers as contracts expired or were renegotiated. This competition is illustrated by the growing U.S. spot market, which has risen in just a few years from almost nothing to over 50 per cent of total U.S. sales in 1987. During the year, the spot price of gas averaged about Cdn. $2 per Mcf, 70-80¢ below the equivalent price for heavy fuel oil.

The drop in the price of gas has led to proportionately larger decreases in the price received by Canadian producers, referred to as the "netback". This situation arises because the cost of transportation, a significant component of the price, has been stable. On the upside, the reverse is also true. As prices increase, producers' netbacks will grow by a larger proportion.

Deregulation at a time of substantial surpluses has also worked against Canadian gas export volumes, which until recently have dropped more rapidly than has U.S. domestic demand. As demand declined, interstate pipelines tended to accept supplies from U.S. rather than Canadian producers. "Take-or-pay" clauses in contracts meant that pipeline companies would have to pay for the U.S. volumes even if they did not take them. For gas producers, reduced revenues over the last several years caused unexpectedly low returns on previous investments and serious drops in cash flow. Under such circumstances, it is difficult for many companies to undertake aggressive exploration programs.

Export revenues received by Canadian gas producers have declined ($ billions)



The trend toward deregulation

Extensive regulation has been a characteristic of the Canadian natural gas business since the late 1950s. At that time, the federal government decided it was in the national interest to provide for a broad domestic gas market. With subsidies given to build a pipeline connecting Western producers with central Canadian consumers, governments proceeded to control prices and collect revenues from the ensuing business.

In the early 1970s, the industry was characterized by very low regulated prices. By the middle of the decade, gas was significantly underpriced compared to oil, contributing to a growing concern about the potential for serious supply shortages in both Canada and the United States. Major shifts in government policy in both countries reflected these concerns, and led to higher gas prices, further exploration and increased supply.

With declining oil prices and falling energy demand in the early 1980s, artificially high gas prices resulted in the surplus that characterizes North American gas markets. Responding to this problem, governments began to dismantle the regulatory framework. In 1984 the uniform border pricing system for natural gas exported to the United States ended. For the first time since the mid-1970s, Canadian producers were allowed to negotiate directly with U.S. buyers, subject to certain conditions.

An agreement was reached in October 1985 between the Canadian federal government and the governments of the gas-producing provinces of Alberta, British Columbia and Saskatchewan on further deregulation. By November 1, 1986, the agreement effectively moved the industry from government-administered prices to a market-oriented price regime for both domestic and exported natural gas. More streamlined and flexible regulatory procedures, including fewer restrictions on exports of Canadian gas, have provided lower prices for consumers and improved market access for producers. Subsequent regulatory changes at federal and provincial levels have been designed to supplement the 1985 natural gas agreement. In September 1987 the National Energy Board eliminated its surplus test, a formula that determined allowable gas export volumes. The new system combines the export application process with regular monitoring to safeguard future Canadian gas requirements.

Deregulation has also occurred in the U.S. natural gas industry. Several decisions by the Federal Energy Regulatory Commission have had the effect of increasing competition, allowing brokers and marketers to arrange sales and transportation of natural gas, and changing the role played by interstate pipelines. Progress toward open-access transportation has encouraged the growth of the spot market and attempts by purchasers to modify long-term gas contracts that typically include take-or-pay clauses.

The new world of deregulation

Deregulation – permitting the price of gas to be determined by market forces rather than government policy – is a positive development for the Canadian gas industry. It has been almost universally applauded by consumers, producers and governments. In the past, producers simply sold the gas they found to pipeline companies at prices set by governments. Under deregulation, gas can increasingly be sold to anyone willing to buy it, including end-use customers, at prices determined through negotiation. These institutional changes require significantly different approaches to the gas business, and involve different risk and reward trade-offs than in the past.

In Canada, most deregulation issues have been resolved, though a few particularly difficult problems remain. Currently under discussion is pricing for the residential, commercial and small industrial customers termed the "core" market. This is a complex issue involving the interpretation of the 1985 Federal/Provincial Agreement on Natural Gas Markets and Prices and the treatment of existing contracts. Most core customers are currently served by previously negotiated long-term contracts between local distribution companies and major shippers, which in turn are backed up by contracts between shippers and producers. Although these contracts have been recently renegotiated to yield lower prices for consumers, it has been suggested that prices would be even lower if existing contracts were voided and core customers were permitted to negotiate directly with producers.

As deregulation unfolds, Canadian producers are working hard to obtain what the process promises – equal access to U.S. customers. The U.S. Federal Energy Regulatory Commission has established a voluntary program for U.S. interstate pipelines to become open-access natural gas carriers for third parties. Unfortunately, the response has been slow. To date, only one U.S. interstate adjacent to the Canadian border can be considered open access. This situation reflects the surplus of gas in the United States, and the existence of significant take-or-pay difficulties between most interstates and U.S. domestic producers. The extent and timing of open access for Canadian gas producers to the major U.S. gas markets remain to be seen.

Gas producers assume risks

As they look ahead toward opportunities presented by deregulation and a shift in the balance between supply and demand, producers have decisions to make. While there are markets that look profitable, there are many risks that must be borne in order to reach them.

Canadian natural gas resources are plentiful. However, finding new reserves, developing fields, building production, gathering and processing facilities, and finally, linking with and negotiating access to major pipeline systems is complex, time-consuming and expensive. On average, this process takes from four to seven years. There is therefore a significant gap between high front-end expenditures and the receipt of revenues.

During the time lag between investments and revenues, both sales volumes and prices will be affected by many factors. These will include the level and volatility of world oil prices, U.S. and Canadian economic activity, conservation and substitution initiatives, evolving government policies, and the supply response of U.S. gas producers as prices begin to rise.

These risks are manageable. Canadian gas producers are assessing the match between their assets and the potential offered by newly opening markets. Management teams are developing strategies that will make the most of growing investment opportunities in the natural gas business.

A stronger natural gas business

The Canadian natural gas industry is attracted by prospects of more stable North American natural gas demand and open access to U.S. markets, coupled with rising prices and declining U.S. supply. Recent downward trends in export revenues should rebound and encourage new Canadian investments. With its large reserves and developed infrastructure, Canada is capable of supplying North American markets with increased gas volumes for many years. Improved export markets and revenues will encourage exploration and development, helping ensure ample, competitively priced gas supplies for Canadian customers. At a time when weak world oil prices place some limits on opportunities in oil exploration and development, the strengthening of the natural gas business will add welcome vitality to the Canadian oil and gas industry.

A promising business for Petro-Canada

Petro-Canada is currently a major player in Canada's natural gas industry. Using latest published data, the Corporation ranks third in proven reserves and fourth in production. It operates 16 gas processing facilities and is a partner in 34 other gas processing plants in the Western provinces. In British Columbia, the Corporation is the industry leader.

Petro-Canada is also a major producer of valuable natural gas by-products. It is part-owner of two natural gas liquids straddle plants, one at Empress, Alberta, and the other at Taylor, British Columbia.

In addition to its reserves position in Western Canada, the Corporation has made significant discoveries of natural gas in the Arctic and East Coast offshore. Petro-Canada owns 52.7 per cent of Panarctic Oils Ltd., the principal explorer in the Arctic Islands over the last 20 years.

Prospects of higher returns in the natural gas business have led Petro-Canada to compete aggressively in the domestic and export sales markets. The Corporation's gas marketing capability has been significantly strengthened and greater attention has been given to gas exploration and development.

The Corporation's strength in the business today, its position in the major opportunities of the future, and its strategic thrust toward a greater emphasis on gas point to a promising future in the industry.

Resources Division

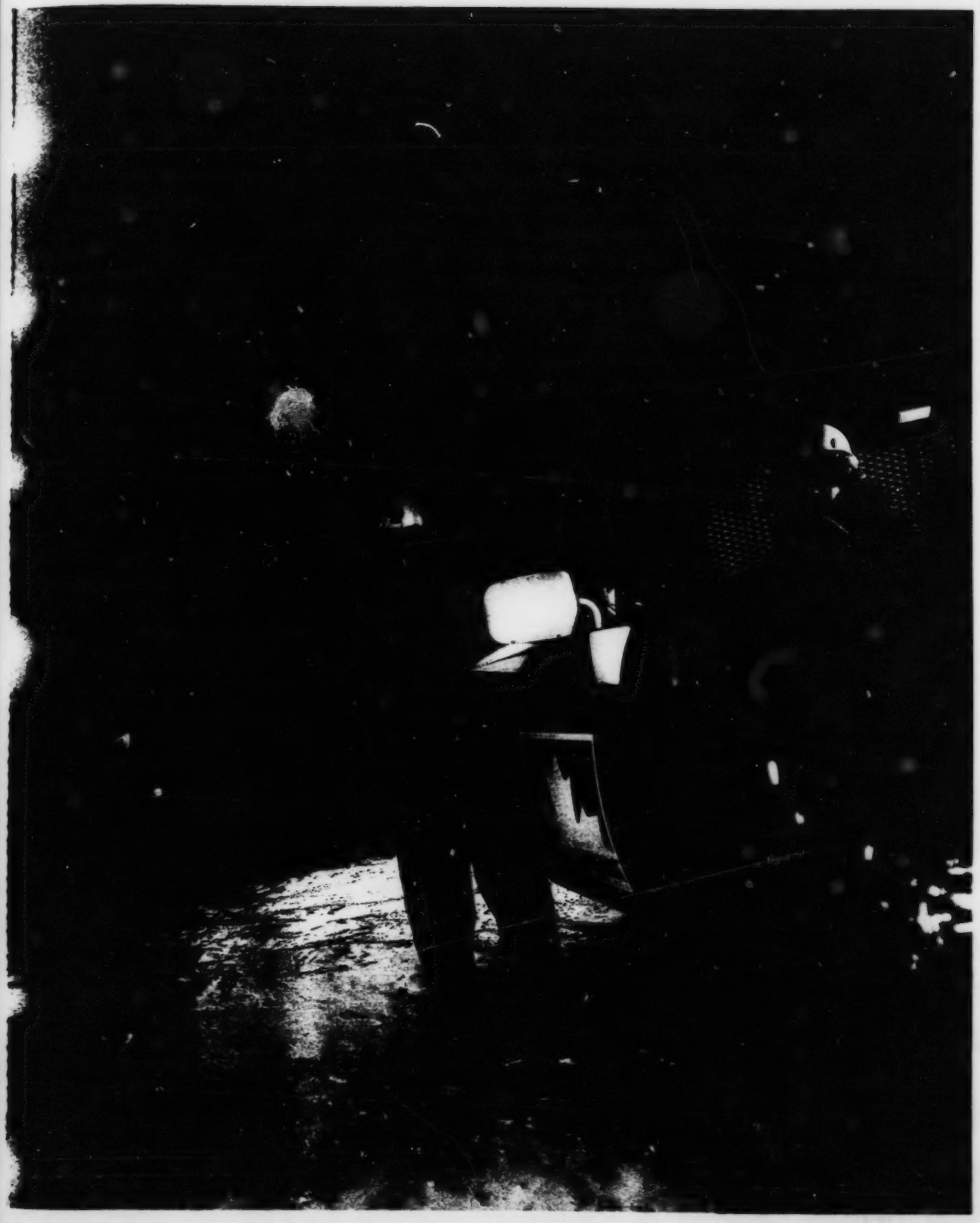
- Earnings almost tripled over 1986
- Petro-Canada captured the benefits of firming oil prices by keeping production at high levels and cutting costs

Financial and Operating Profile

Financial	1987	1986
Revenue (millions of dollars)	1 138	1 080
Earnings (millions of dollars)	162	57
Cash generated from operations (millions of dollars)	563	399
Net capital expenditures (millions of dollars)	336	316
Average capital employed (millions of dollars)	4 155	4 104
Cash flow return on average capital employed (per cent)	13.9	10.0

Operating	1987	1986
Crude oil and field natural gas liquids production, net before royalties (thousands of m^3 per day)		
Conventional crude oil	10.1	10.1
Synthetic crude oil	3.7	3.5
Bitumen	0.5	0.6
Field natural gas liquids	2.1	2.1
Total	16.4	16.3
Natural gas production, net before royalties (millions of m^3 per day)	12.3	10.2
Natural gas liquids production from straddle plants including ethane (thousands of m^3 per day)	6.3	6.5
Proven reserves of crude oil and natural gas liquids, net before royalties (millions of m^3)	89.0	90.1
Number of years of production of crude oil and natural gas liquids represented by remaining proven reserves	15	15
Proven reserves of natural gas, net before royalties (billions of m^3)	96.9	96.7
Number of years of production of natural gas represented by remaining proven reserves	22	26

Bellshill Lake is Petro-Canada's top conventional oilfield. Superintendent John Hawkins and system analyst Lori Clipperton use computerized data to fine-tune production operations.



In 1987 the Resources Division recovered from the difficult year experienced in 1986. Earnings reached $162 million, nearly three times the $57 million for the previous year. Cash generated from operations amounted to $563 million, up 41 per cent from $399 million in 1986. Cash flow return on average capital employed was 13.9 per cent, up from 10.0 per cent in 1986.

Western Canadian conventional operations remained central to the Division's results. Production was maintained at high levels, allowing the Corporation to capture the benefits of stronger world oil prices. The oil price increase accounted for much of the revived earnings performance and offset the effect of weaker natural gas prices. Higher profits also reflected the impact of improved fiscal terms enacted by governments and productivity initiatives implemented during the year.

In late 1986, governments responded to the dramatic declines in oil and gas prices by removing the Petroleum and Gas Revenue Tax and making other royalty and tax changes. These changes had the effect of improving unit production margins in 1987 to levels close to those prevailing in 1985 when prices were about U.S. $30 per barrel.

To contribute to the Corporation's financial performance objectives, the Resources Division followed carefully devised strategies that recognize the Corporation's breadth and balance and need for long-term growth. These strategies involve incrementally developing in situ and mineable oil sands, selectively investing in offshore and international prospects, placing more emphasis on natural gas, and optimizing revenues from existing assets. Though the focus of capital spending was on Western Canadian conventional operations, developing future opportunities also required investments.

Actively pursuing oil sands development

In 1987 the Corporation moved forward with phased development of in situ oil sands and expanded activity in mineable oil sands.

At the Wolf Lake project, in east-central Alberta, construction began on a second phase of development. Petro-Canada has a 50 per cent interest in this partner-operated, commercial in situ oil sands project. Gross daily production capacity will increase from 1 300 cubic metres to about 3 300 cubic metres by late 1989, resulting in lower overall unit operating costs. Increased revenues will total approximately $70 million per year at 1987 bitumen prices.

The second phase involves the addition of 250 wells by 1989 plus approximately 50 wells in each subsequent year through the life of the project. The central steam generation and production handling facilities will also be expanded. Total capital costs for the 25-year project are estimated at about $750 million in 1987 dollars, including pre-production costs of about $200 million. Some 360 workers will be employed at the peak of construction and approximately 40 permanent jobs will be created when the expansion is fully operational. In 1988 Petro-Canada and its partner are planning to test a pilot combustion project designed to boost bitumen recovery rates.

The Syncrude oil sands mining project achieved its third consecutive year of record production. Petro-Canada has a 17 per cent interest in the project and serves on its management committee. In 1987 Petro-Canada's share of production was 3 700 cubic metres per day, yielding revenue of $201 million, up 17 per cent from 1986. Production will increase by 14 per cent with the completion of the capacity addition project in 1990. Currently, the Syncrude plant produces about 11 per cent of Canada's crude oil.

Syncrude management has reduced unit operating costs about 40 per cent in as-spent dollars since the early 1980s. Greater efficiency has resulted from improved operating practices and modifications to equipment. For example, the planned interval between major maintenance turnarounds for the two coking facilities has been increased to 18 months, and the duration of the shut-down period has been reduced.

During 1987, the Syncrude participants proceeded with engineering work to determine the feasibility of a $4 billion plant expansion which would increase production capacity by a further 50 per cent. These studies will continue during 1988 with support from the Government of Alberta.

Petro-Canada has large landholdings in both in situ and mineable oil sands and routinely evaluates development opportunities. The Corporation and five other participants began discussions with governments during the year on the feasibility of a $4 billion oil sands mining project known as OSLO. Located at Kearl Lake, near Fort McMurray, the project lease

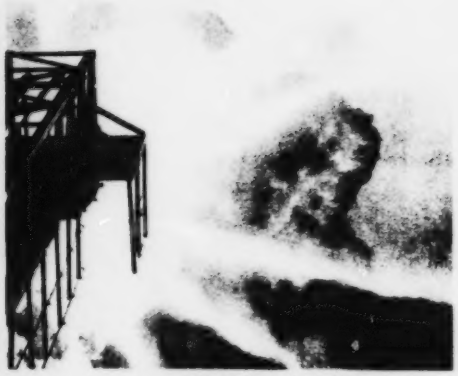
The Wolf Lake in situ oil sands operation is being expanded to more than double its production. Petro-Canada is a 50 per cent partner in the project.

contains large, high-quality deposits. In addition, Petro-Canada continued its involvement with several in situ test facilities in northeastern Alberta.

Selectively investing in offshore and international prospects

The Corporation focused its 1987 East Coast offshore activity on the most promising development opportunities.

On the Grand Banks, Petro-Canada drilled a delineation well in the Terra Nova oilfield where the Corporation holds a major interest and is the operator. The well, which was tested in November, generated very encouraging results, confirming field reserve estimates. With improved production prospects, Petro-Canada now has increasing confidence in the feasibility of a Terra Nova development project. In December, Petro-Canada began a seventh delineation well. Work on development alternatives involving floating production systems began during 1987 and will be completed at the end of 1988. Current plans indicate that, given continued drilling successes and timely regulatory approvals, construction could begin by 1991.



Eventual production from the Terra Nova oilfield off Newfoundland moved closer following successful testing at the H-99 delineation well.

In August, Petro-Canada completed a delineation well in the Panuke field, 250 kilometres east of Halifax. During testing, a tanker load of oil recovered from the well was shipped to Petro-Canada's Montreal refinery for commercial processing. Reserves found to date are relatively small for an offshore development.

Discussions with partners and governments continued during 1987 on the development of the Hibernia oilfield off Newfoundland, though fiscal terms remained unresolved at year end. Petro-Canada is committed to participate in the development should negotiations lead to an agreement.

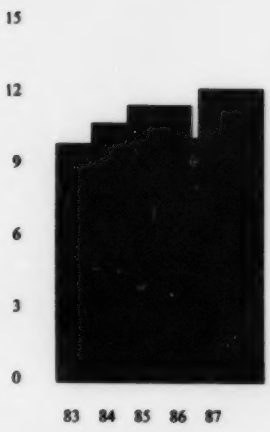
In 1987 the Corporation reduced frontier land expenditures. Only those frontier landholdings containing significant discoveries or possessing definite medium-term exploration potential were retained. As a consequence, exploration rights were relinquished in large areas off the East Coast and in the North.

During the year, Petro-Canada increased its emphasis on international programs. Given the likelihood that weak world oil prices will lead to the deferral of many Canadian oil and gas projects, the Corporation is examining a number of attractive international opportunities for the exploration and development of inexpensive reserves. As operator, Petro-Canada led two exploration ventures in Colombia and one in Papua New Guinea; work undertaken in 1987 consisted of geological, geophysical and drilling activity. After being awarded a service contract for operations in the Oriente region of Ecuador, Petro-Canada established in Quito its first foreign office. Petro-Canada also participated in exploration ventures in Indonesia, Spain and Colombia. Revenues of $21 million were received from production at the partner-operated Casablanca oilfield in offshore Spain.

Increasing emphasis on natural gas

As expected, surplus natural gas supply and declining prices depressed the financial performance of the natural gas business. Petro-Canada's production at 12.3 million cubic metres per day was up over 1986, but the average field-gate price received for natural gas fell from about Cdn. $2.10 per Mcf in

Natural gas production,
net before royalties
(millions of m^3 per day)



1986 to $1.60 in 1987. This meant that even though production rose, revenues were lower than in the previous year.

In spite of this situation, Petro-Canada took a number of steps to gain efficiencies and position itself for future market opportunities.

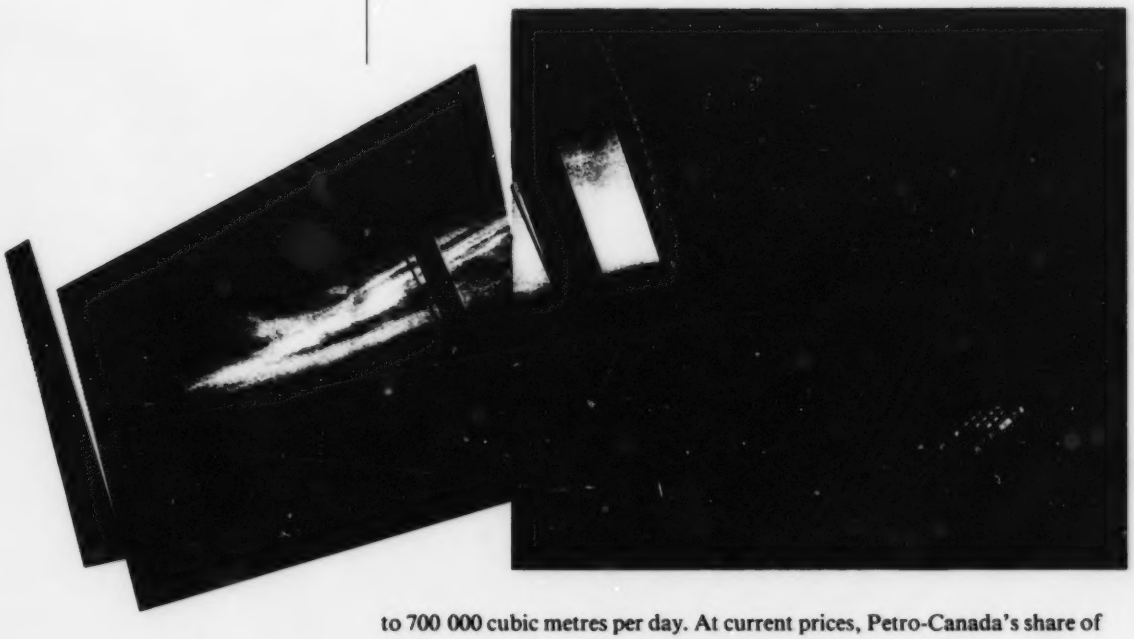
The Corporation strengthened its natural gas marketing capability. Currently, 4 per cent of Petro-Canada's production is used in direct sales, 23 per cent goes to internal markets and 73 per cent is handled by Canadian shippers. During the year, direct sales contracts were renewed with three B.C. industrial end-users, and the Corporation made its first direct spot market sale to an industrial consumer in the U.S. Pacific Northwest. Petro-Canada also completed arrangements to increase gas supplies to internal markets including, for the first time, the Montreal refinery.

Additional natural gas sales continue to be hindered by complex regulatory requirements, specifically in pipeline transportation. Petro-Canada took steps to secure long-term, contracted transportation services in British Columbia to facilitate the future movement of its gas to market.

During the year, some previously unconnected reserves were tied in, such as the Pembina Keystone and Chard fields in Alberta. Productivity at producing fields was also increased through facility improvements.

In December, Petro-Canada and its partners requested approval from the Alberta Energy Resources Conservation Board for an $89 million expansion to the Brazeau sour gas facility which the Corporation operates in west-central Alberta. Petro-Canada and its partners will participate in public hearings in 1988. The expansion will include additional production wells and an enlarged gathering system. Expected to come on stream in late 1989, it will increase Petro-Canada's share of natural gas processing capacity 140 per cent

John Birt of Skeena Cellulose Inc. and Jerry van der Linden, Petro-Canada's manager of natural gas market development, watch as bales of pulp are prepared for shipment. Petro-Canada supplies gas directly to the Skeena Cellulose pulpmill at Prince Rupert, British Columbia.



Lori Clipperton, project system analyst in Calgary, monitors data from field locations across Alberta. The new, integrated production data system provides a single computerized data base from which production operations are managed.

to 700 000 cubic metres per day. At current prices, Petro-Canada's share of additional revenues will be $8.5 million per year.

In October, a six-inch pipeline was completed between Petro-Canada's wholly owned Petroleum Transmission Company pipeline and the Cochin pipeline near Regina, Saskatchewan. The $1 million investment enables liquefied petroleum gas to be shipped more economically and with greater flexibility from the Corporation's Empress straddle plant to markets in Central Canada and the United States. During the year, Petro-Canada also improved transportation access on the Cochin pipeline to the petrochemical market in Sarnia, Ontario; this in turn helped strengthen demand for propane produced at Empress.

Optimizing revenues from existing assets

The upstream business is largely driven by external forces, especially world oil prices. Success hinges on increasing margins through finding better ways to use existing assets and minimize costs.

Based on the experience gained at six test locations in 1986, Petro-Canada effected major changes in the management of Company-operated oil and gas fields in Western Canada. By year end, a management approach characterized by integrated reservoir and production management teams had been implemented at 16 of Petro-Canada's major fields. A typical team consists of supervisory and working-level representatives from reservoir, production and facilities engineering, and the operations group. Their goal is to balance short-term demands for maximum volume with the longer-term need to manage reserve depletion.

Petro-Canada's top revenue-generating conventional field, at Bellshill Lake in east-central Alberta, illustrates the approach. The Bellshill Lake team conducted plant and field capacity testing and used the results to lower operating costs and maximize lifting capability with the existing equipment. The team also designed and implemented, within just six months, a $6.5 million, 17-well infill drilling program that increased total field oil

production by 9 per cent. The same approach has been adopted at some of the Corporation's smaller fields. At the Kobes gas field in northeastern British Columbia, one such team significantly increased production by undertaking additional drilling, installing compression with state-of-the-art equipment, and building new facilities.

In numerous instances, individual employees proposed cost control and margin improvement programs. While most initiatives were relatively small, the cumulative effect reached approximately $11 million.

Well performance was enhanced at Petro-Canada's Cactus Lake and Salt Lake heavy oil fields in Saskatchewan. A unique concept using produced gas to fuel pump motors eliminated the need for large quantities of propane. These modifications gained yearly savings of approximately $500 000. In another instance, staff replaced the conventional steel rods used to pump oil from the Utikuma oilfield in north-central Alberta. Made of fibreglass, the new rods are lighter and more flexible and have resulted in lower operating costs and a 70 per cent increase in oil production.

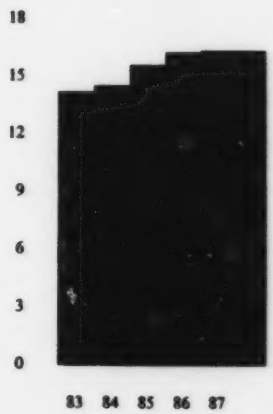
Work at the Smiley oilfield in western Saskatchewan was an example of facility optimization. The installation of a compressor made it possible to lower pressures in the field gathering and processing system while maintaining sales of associated gas to a local utility at contracted pressures. The lower system pressures enabled more oil to flow into the well bores, increasing total production from the field by 10 per cent.

Certain changes in business procedures also led to higher profits. An example was the implementation of a computer system to monitor electrical purchases for production facilities. When fully operational in the spring of 1988, the system will streamline procedures, compare actual with budgeted billings and flag excessive expenditures. By year end, it was already evident that systematic management of purchases could reduce total electricity expenditures by about $800 000 per year.

Computerization enabled Petro-Canada to begin an integrated production data system. This system will reduce costs over the longer term by facilitating quicker responses to operating problems as well as more efficiently meeting external reporting requirements.

During 1987, production, drilling and engineering groups in Western Canada implemented a comprehensive loss control program. An international rating system is being used to improve working conditions, reduce losses and heighten awareness of personal and equipment safety. Results for the year included the development of a computerized loss event reporting program, investigation and analysis of losses, and the design, implementation and evaluation of preventive measures. Compared to 1986, revenue losses and other costs due to interruption of operations, equipment damage and preventable accidents dropped by 50 per cent. Disabling injuries were halved and preventable vehicle accidents were down by about 45 per cent.

Crude oil and field natural gas liquids production, net before royalties (thousands of m^3 per day)



Products Division

- Earnings and margins squeezed by price cutting in wholesale and retail markets
- Focus on strengthening customer loyalty while reducing operating costs

Financial and Operating Profile

Financial	1987	1986
Revenue (millions of dollars)	4 461	4 588
Earnings (millions of dollars)	95	115
Cash generated from operations (millions of dollars)	330	346
Net capital expenditures (millions of dollars)		
Property, plant and equipment	122	112
Acquisitions	—	301
Average capital employed (millions of dollars)	2 757	2 846
Return on average capital employed (per cent)	3.4	4.0

Operating	1987	1986
Petroleum product sales (thousands of m^3 per day)	45.6	44.4
Number of retail and wholesale marketing outlets	4 268	4 344
Refinery crude capacity (thousands of m^3 per day)	64.0	64.0
Crude oil processed by Petro-Canada (thousands of m^3 per day)	48.4	47.2
Refinery utilization (per cent)	76	74

Petro-Pass is Canada's number one truck fuelling network. The system offers truckers convenient, round-the-clock card-activated access to fuels and lubricants at 104 locations across Canada.

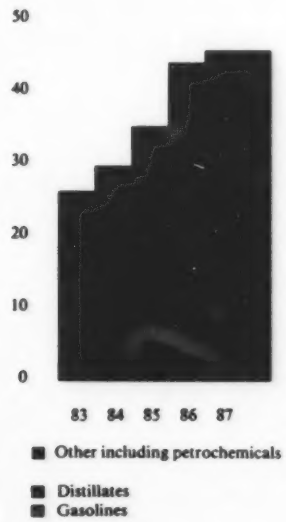
Results for the Products Division in 1987 were limited by several external factors. As a consequence, earnings of $95 million were down 17 per cent from a year earlier. Cash generated from operations amounted to $330 million, 4.6 per cent less than in 1986. Return on average capital employed was 3.4 per cent.

Although Canadian demand for petroleum products rose slightly in 1987, surplus refining and marketing capacity continued to hold industry profitability at disappointing levels. Profit margins were squeezed during 1987, particularly in the second half of the year when product prices did not fully recover rising costs, particularly for crude oil. In the fourth quarter of 1987, average product prices actually fell. In Eastern Canada, intervention in the market by several provincial governments led to ceilings or rollbacks on petroleum product prices. In Western Canada, intense competition also pushed prices below levels necessary to provide adequate returns.

For Petro-Canada, petroleum product sales increased approximately 3 per cent. Sales of gasoline were stable while sales of distillates were up slightly. Volumes of crude oil processed were up 2.5 per cent from 1986 with refinery utilization for the year averaging 76 per cent, up from 74 per cent in 1986.

The Products Division continued to seek improvements in profitability by concentrating on four key strategies: providing superior customer service, maximizing revenues from existing marketing assets, cutting costs in refining, and seeking operating efficiencies through computerization and integration.

Petroleum product sales
(thousands of m^3 per day)



Placing customers first

Petro-Canada recognizes that satisfied customers are critical for earnings growth in its business. For this reason, the Corporation's downstream activities are driven by the needs of the customer.

In retail operations, Petro-Canada implemented national service standards and trained over 6 000 retailers and station attendants. A program to encourage community participation and improve image, called Club Excellence, was expanded during the year. A special President's Award was introduced to give recognition to outstanding performers. In addition, a national business associates council was established. The council will meet regularly with Petro-Canada management to improve retail operations.

Better communications with customers is a top priority. Petro-Canada introduced a toll-free customer service line linked to the Corporation's retail credit card centre. Centralized computer tracking guarantees effective management of all queries, complaints, compliments and suggestions. This service, available at year end in the Maritimes and Ontario, will be expanded nationally in 1988. Products Division management also organized customer appreciation days in cities across the country. Employees from

throughout the Division volunteered to spend a day at a service station, helping to promote Petro-Canada's products and services and gaining an appreciation of motorists' needs. These kinds of initiatives are central to building a stronger bond between Petro-Canada and its customers.

Service standards are also being strengthened in wholesale and commercial operations. For instance, new training modules were introduced, the Club Excellence program was enhanced, customer appreciation days were held at major trucking facilities, and a national business council for wholesale agents was established. In addition, two major customer-focused programs were expanded during the year.

One of these is Petro-Pass, the country's foremost truck fuelling network. This system offers truckers convenient card-activated access to fuel and lubricants throughout the country on a round-the-clock basis. At some of the outlets, special services are available such as accessory shops, showers and overnight parking. During 1987, the Corporation expanded the Petro-Pass system, adding 18 new facilities, mainly in Quebec and Atlantic Canada. By year end, Petro-Pass was a truly national network comprising 104 outlets at locations no more than 600 kilometres apart.

Petro-Canada's national fleet fuel and maintenance program was also expanded, resulting in increased sales of fuels and lubricants. Drivers of fleet vehicles can use special fleet credit cards for purchases at any one of the Corporation's retail outlets. Specialized fleet maintenance services are provided at Petro-Canada outlets designated as authorized fleet care centres. During 1987, 50 more centres were added, bringing the total to 360 across the country.

Randy Parcels, a pipeline logistics specialist in Calgary, gains a better understanding of motorists' needs while meeting the public during customer appreciation day.

Petro-Canada's focus on the customer was also demonstrated following an unexpected difficulty in lubricants production. In June, a fire caused by equipment failure resulted in severe damage to the HydroTreater refining unit at the Clarkson lubricants plant in Mississauga, Ontario. Rapid responses by the local fire department and Petro-Canada staff ensured the fire was quickly contained and that no injuries occurred. Nonetheless, the damage jeopardized Petro-Canada's ability to supply customers that relied on the quality inherent in lubricants produced through the HT process.

By bringing in partially processed product from Petro-Canada's Montreal refinery, hydrotreated base stock from foreign plants and some finished products from Canadian suppliers, the Corporation continued to supply all of its blended lubricants customers and some of its process oil customers. Those whose requirements could not be met were assisted by a Petro-Canada staff team in obtaining suitable short-term alternative supplies. At year end, construction was under way on new vessels for the HydroTreater; with startup anticipated in July 1988, Petro-Canada will resume production and delivery of a complete range of top-quality lubricants.

Increasing revenue from existing assets

To increase revenues from existing marketing assets, the Corporation sought to strengthen petroleum and petroleum-related operations. Existing programs were developed more fully and new businesses were introduced to achieve this objective.

During 1987 Petro-Canada introduced a new line of franchises in automobile maintenance and repairs. Called Certigard, it is a comprehensive

Dick Klumpenhower, a Calgary Certigard manager, discusses service requirements with a customer. Certigard is Petro-Canada's unique new personal car care business.

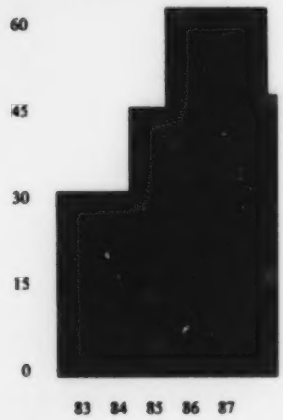
Dee Parkinson, refinery manager, and Frank Hunt, Syncrude area supervisor, review data in the synthetic crude control room of the Edmonton refinery. Petro-Canada has announced an integration of its Edmonton and Port Moody refineries.

blueprint for success in this sector, covering customer relations practices, service procedures, management systems, facilities and equipment, technical training, products and marketing. The elements are designed to work as a system to boost efficiency, and attract and retain customers by offering unmatched service. By year end, arrangements had been made to implement the Certigard franchise at 51 Petro-Canada retail outlets; further expansion will occur in 1988.

In the past, Petro-Canada has participated significantly in the convenience store market through association with national "c-store" chains. However, recognizing the potential for increased revenues by offering one-stop shopping, the Corporation is establishing its own identity in the convenience store business. By year end, 12 new stores were operating at Petro-Canada facilities under the Neighbours banner or as Le Frigo in Quebec. Sales of both convenience items and gasoline at the initial locations have exceeded expectations. The Corporation plans further development of this program in 1988.

With the premier network of tunnel car washes in Canada, Petro-Canada washes over 11 million cars a year at 200 locations. This activity generates significant revenues and also enhances the Corporation's gasoline sales. In 1987 Petro-Canada began a program to gain greater value from this asset. The Corporation is upgrading its equipment, improving its operating practices and enhancing staff training. These plans have been developed to increase loyalty and gain new customers by building on the Corporation's advantage in tunnel car washes.

Refinery capacity and crude oil processed
(thousands of m³ per day)



Cutting costs in refining

In order to improve refinery utilization, the Corporation plans to integrate the refineries in Edmonton, Alberta, and Port Moody, British Columbia, effective in the fall of 1988. Partially processed feedstock will be shipped from Edmonton to Port Moody via the TransMountain pipeline for final processing and blending into finished products.

The decision will result in the closing of Port Moody's catalytic cracking and alkylation units. Many of the affected employees will be offered positions elsewhere in the organization.

Besides improving refinery utilization, the integration of the Edmonton and Port Moody facilities takes full advantage of Edmonton's strengths in crude refining and Port Moody's octane generation capability. The Port Moody refinery will continue to supply West Coast markets with customized gasolines, diesel fuels, heating oil and jet fuel.

Since September 1986, the Corporation has been actively engaged in a crude oil futures trading program. The primary purpose is to hedge against adverse price movements in the Corporation's basic products. This trading is conducted under carefully controlled conditions and the results are regularly monitored. By hedging the Corporation's physical barrel exposure to adverse price movements, futures trading provides relative stability in an otherwise volatile international environment.

Gaining efficiencies through computerization and integration

Following a successful pilot program in 1986, the Corporation began installing electronic credit authorization terminals at its service stations. By early 1988, the equipment will be in place at about 2 500 high-volume locations across the country and will handle most of the Corporation's annual load of 55 million credit card transactions.

Petro-Canada's customers find the system more convenient; it takes about 20 seconds to process a purchase using the credit authorization terminal, including less than six seconds to verify the card. The system also speeds up credit card billing and reduces card processing errors. The Products Division obtains savings through the freeing-up of working capital and the reduction of operating costs. With less paperwork, service station dealers benefit from improved invoice records and simplified bookkeeping.

In product distribution, continued rationalization and computerization produced further efficiencies. The improved light oil distribution system, introduced in 1986, was expanded to Quebec and the Maritimes and small centres throughout Canada. This system automates inventory control and improves delivery scheduling to company outlets and customers. In

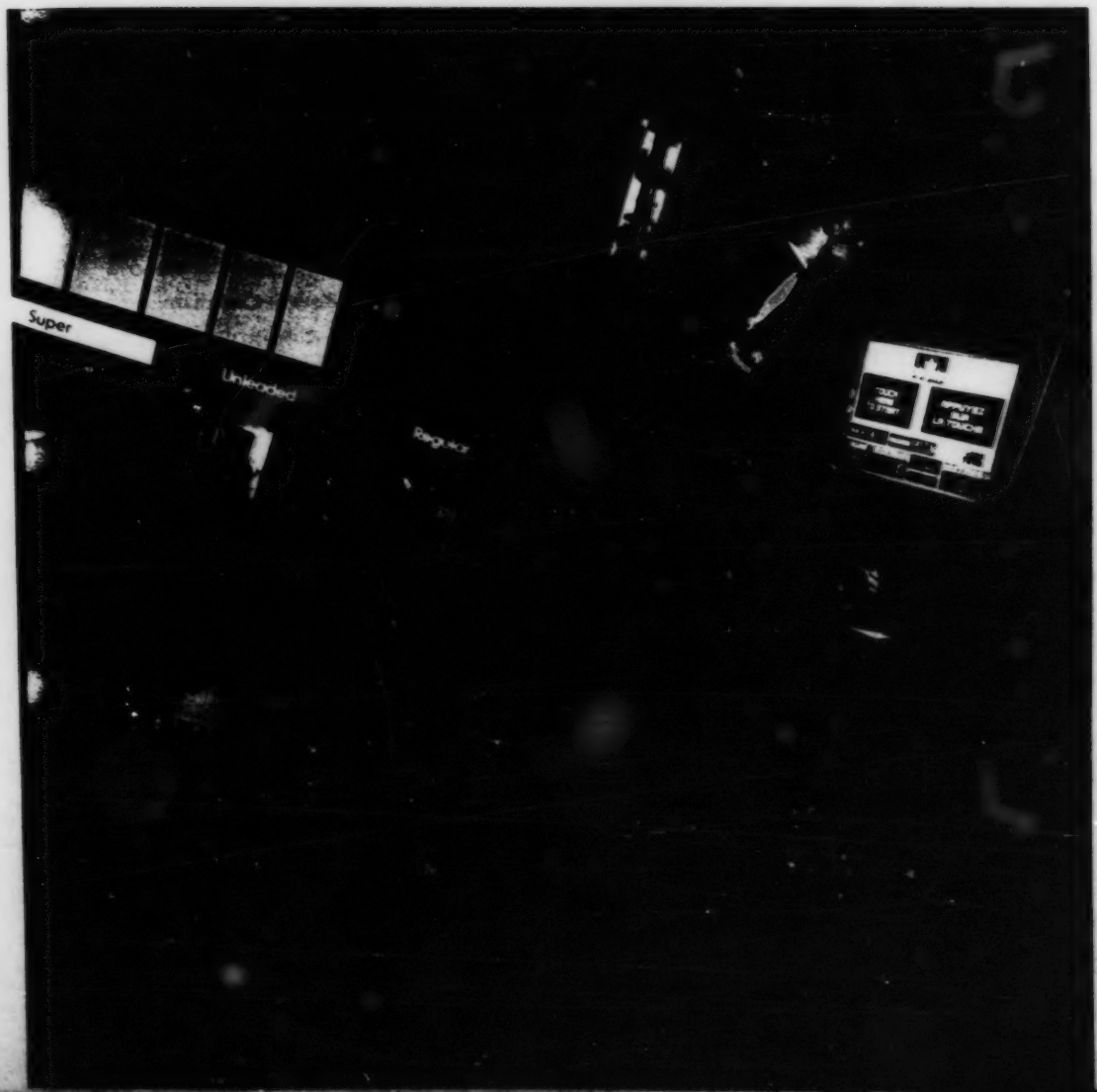
addition, automation was begun at the Corporation's commissioned bulk outlets in late 1987. Benefits include lower requirements for working capital and improvements in order entry, delivery scheduling and inventory management.

Integration of the former Gulf marketing operations, which was largely completed in 1986, created a number of opportunities for efficiency improvements in 1987.

Multi-departmental teams standardized retail accounting, credit and distribution practices. In little more than one month, hundreds of thousands of retail accounts were converted to descriptive billing. Subsequently, retail credit cards issued by Gulf were replaced with new Petro-Canada cards. The re-identification of retail facilities was accelerated during the year and is scheduled for completion in early 1988.

Toronto area staff moved from three separate office buildings to the North York City Centre in the early part of the year. The new building now serves as the principal office for personnel located in Ontario. The improved communications and team spirit resulting from the move have led to greater operating efficiencies.

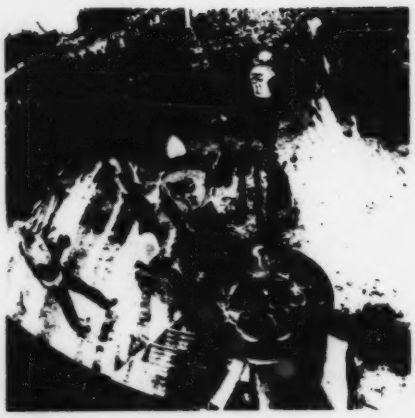
Petro-Canada is experimenting with a Canadian innovation that offers the ultimate in self service. A touch-activated laser video-screen is linked to gas pumps and speaks directly to customers, helping them dispense gasoline and allowing payment in a matter of seconds.



Corporate Responsibility

Petro-Canada works hard to develop and maintain a special relationship with the people of Canada. As Canada's national energy corporation, Petro-Canada has certain responsibilities: a focus on Canada in its business decisions, a special attention to operational safety and environmental protection, and a respect for the communities in which it does business.

This winter's Olympic Torch Relay is an excellent example of the potential that comes with Petro-Canada's identity. The Corporation's role in organizing the relay and transporting the Olympic flame across the country demonstrates the value that can be achieved from a commitment to the country and an ability to do a job well.



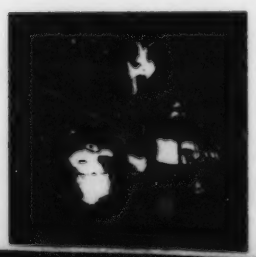
In late 1985, when Petro-Canada won the right to stage the torch relay for the XV Olympic Winter Games, the Corporation recognized it had made a decision that went far beyond an exercise in good corporate citizenship. Rather than simply buying a sponsorship position that could be used in marketing, Petro-Canada accepted a much greater task – to actually organize and carry out an Olympic event.

To make the most of its $6.9 million investment, Petro-Canada took the event in a completely new direction. For the first time in history, the torch relay was opened up to all people in the host country – any Canadian could apply to be one of the nearly 7 000 who would bear the torch. A route was selected that would allow as many people as possible to view the passage of the flame first-hand; 90 per cent of Canadians live within a two-hour drive of the route.

Public involvement in the Olympic Torch Relay was encouraged. To select torchbearers, invitations were sent to all Canadian homes and an independent firm was then commissioned to supervise a lottery and draw winners from the 6.7 million applications. The torch was designed to resemble the Calgary Tower and was manufactured in Canada with Canadian materials. All torchbearers were provided with colorful, high-quality running suits, custom-designed by a Calgary manufacturer.

Advertising and marketing budgets were redirected to torch relay-related initiatives. During the last two years, many millions of commemorative glasses were sold to the public, raising $4 million for an Olympic scholarship program called the Petro-Canada Olympic Torch Relay Legacy Fund.

During the 88 days that the flame passed across the country, the response of Canadians was impressive and moving. For the Corporation, the endeavor was so successful that benefits go far beyond any incremental retail sales. For the nation, new meaning has been injected into the concept of Olympic spirit. Canadians have set a new standard by which all future Olympics will be judged.



Petro-Canada employees share the flame

Petro-Canada employees began the task of organizing the torch relay in late 1985. A small management staff, reporting through the Products Division, was drawn from operating groups. Once the nature of the event was established – a relay open to any Canadian, a route spanning the country, a lottery to select torchbearers and special kilometres designated for Native and handicapped Canadians – the staff was expanded to 10 and detailed planning began.

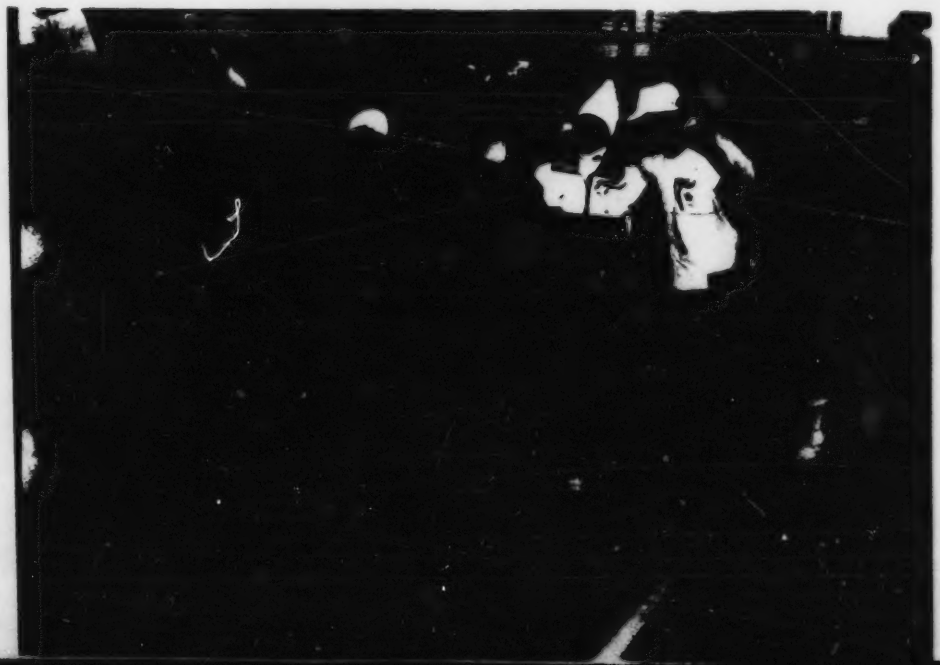
The enormity of the task meant that relay staff frequently had to request help from other employees. For instance, each of the 11 000 kilometres travelled on land had to be carefully mapped out; volunteers repeatedly drove stretches of the route, noting landmarks and possible problems, and suggesting alternative roads to make the relay safer and more accessible for spectators.

As the Calgary manufacturer delivered the thousands of uniforms needed for the event, dozens of Petro-Canada employees gave their own time to sort and pack them into individual bags for torchbearers and caravan staff members.

A torch was needed that would withstand high winds and frigid conditions, would burn brightly and with an orange flame, yet would be safe and relatively smoke-free for indoor ceremonies. Staff at Petro-Canada's Sheridan Park Research Centre formulated and tested the fuels for the job.

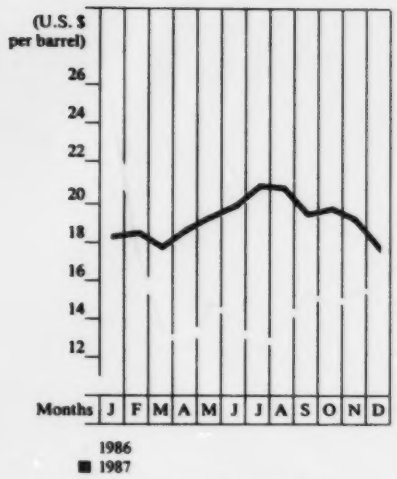
From the time the flame arrived in Newfoundland from Greece until the Opening Ceremonies in Calgary, 700 employee volunteers spent week-long shifts working on the caravan. They drove the vehicles, ran as escorts with torchbearers and, with painstaking attention to detail, coordinated the complex day-to-day logistics.

Throughout the planning and staging of the event, staff across the Corporation added enthusiasm and shared expanded workloads. In these ways, all Petro-Canada employees made a contribution to the XV Olympic Winter Games.



The 88-day Olympic Torch Relay brought the Olympic spirit to millions of Canadians.

Crude oil prices*
Crude oil prices were higher and more stable in 1987 than in 1986, but well below levels prevailing in 1985.



*based on average NYMEX prices (one-month forward) for West Texas Intermediate at Cushing

Responding to an uncertain world oil market

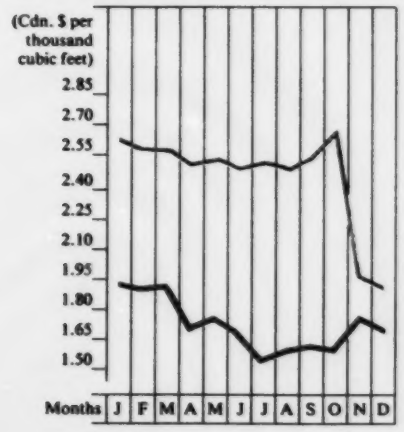
Petro-Canada's financial and operating results for 1987 were improved, largely as a result of increased prices for crude oil. In 1986, international crude oil prices dropped sharply to nearly U.S. $10 (Cdn. $14) per barrel and fluctuated for much of the year. With the introduction of deregulation in late 1986, natural gas prices also fell dramatically. As a result, oil and gas production revenues and the value of reserves remaining in the ground fell substantially in that year. During 1987, the international crude oil market was more stable and prices ranged from U.S. $16 to $22 (Cdn. $21 to $29) per barrel, averaging over U.S. $19 (Cdn. $25) for the year. Field-gate natural gas prices averaged approximately Cdn. $1.60 per Mcf in 1987 versus Cdn. $2.10 per Mcf in 1986.

Contributing significantly to Petro-Canada's improved 1987 results were the programs established during 1986 to cut costs whenever possible, downsize the organization and enhance operational flexibility.

Financial results encouraging

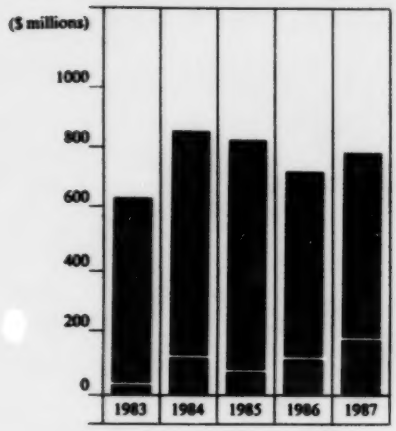
Consolidated earnings after redeemable preferred share dividends were $172 million in 1987, up 40 per cent from $123 million in 1986. Reflecting the improvement in crude oil prices and the continuing realization of efficiency measures initiated in 1986, Resources Division earnings increased from $57 million in 1986 to $162 million in 1987. Products Division earnings dropped from $115 million in 1986 to $95 million in 1987 due to a combination of factors that depressed profits in the industry. Corporate and other activities resulted in a loss of $44 million largely as a result of an increase in deferred profit in inventory due to higher crude oil prices.

Natural gas prices*
Following the implementation of deregulation in late 1986, natural gas prices declined dramatically. Prices remained under severe pressure in 1987 because of surplus supply in North America.



*based on industry average of Alberta field-gate prices

Cash generated from operations versus net earnings*
Cash flow available for the Corporation's purposes continues to be strong at $778 million in 1987. Earnings rose 40 per cent in 1987.



*after dividends on redeemable preferred shares, before extraordinary and unusual items

Cash generated from operations of $778 million in 1987 was up 9 per cent from $711 million a year earlier. Cash generated by the Resources Division increased substantially from $399 million in 1986 to $563 million. Cash contributions from the Products Division declined from $346 million in 1986 to $330 million in 1987.

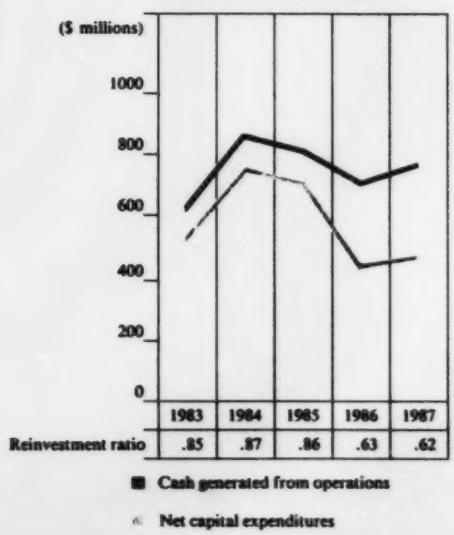
Net capital expenditures of $483 million were 8 per cent above 1986 levels, with new investment directed primarily to the Resources Division. In addition, requirements for working capital in 1987, primarily related to Products Division inventories, were $244 million compared with a reduction of working capital in 1986 of $406 million.

Average capital employed by the Corporation in 1987 amounted to $7 353 million, compared with $7 226 million a year earlier. Cash flow return on average capital employed increased from 10.7 per cent in 1986 to 11.3 per cent in 1987. This key measure of the Corporation's performance has remained very close to the level prevailing in 1985 despite the world oil price collapse.

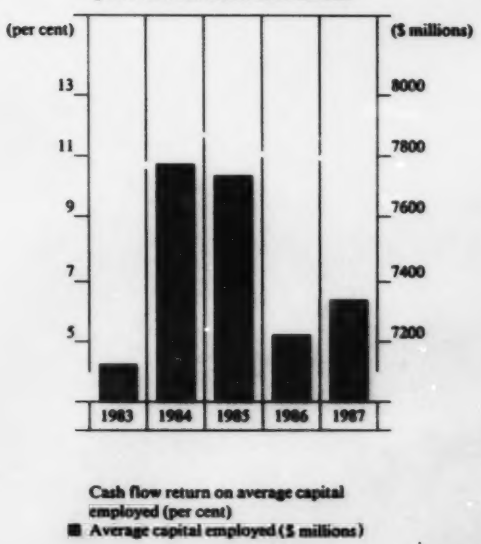
Investment activities appropriate for current business environment

Capital expenditures were increased in 1987 with emphasis placed on investing for short-term cash flow while at the same time maintaining interests in the more promising, longer-term development projects. In particular, gross investments in the Corporation's exploration program were reduced and the focus was shifted from the frontiers to conventional oil and gas properties in Western Canada. Capital expenditures in the refining and marketing business were also limited to the extent possible during integration of the former Gulf operations. The Corporation continues to invest within the framework of

Cash flow and reinvestment
Investment in 1987 responded to improving cash flow and the more stable and attractive business climate.

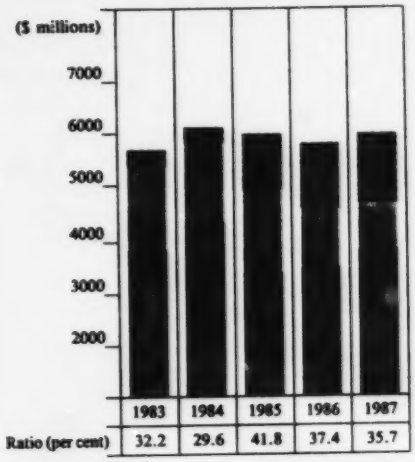


Profitability
Cash flow return on average capital employed was sustained at approximately 11 per cent over the last two years in spite of difficult business conditions.



current and prospective levels of cash generated from operations. Gross capital expenditures for exploration and development of Western Canadian conventional oil and gas were approximately $101 million and $108 million, respectively. Spending in frontier areas was $41 million and in oil sands $79 million. Capital expenditures for refining and marketing totalled $122 million.

Financial position
Debt plus redeemable preferred shares to capital, shown below as "Ratio", has averaged 35 per cent over the past five years. The ratio has steadily improved since 1985.



*valued at year-end U.S. $/Cdn. $ exchange rates
**retained earnings reflect the valuation of redeemable preferred shares at year-end U.S. $/Cdn. $ exchange rates

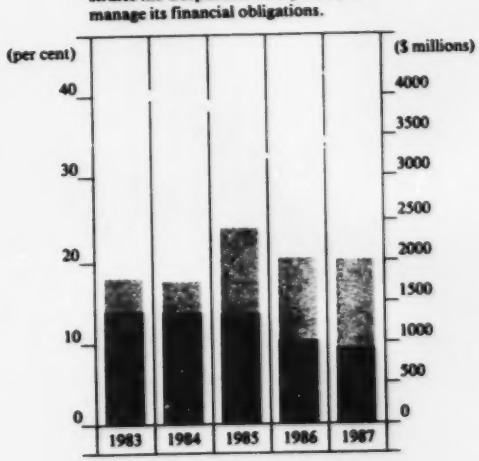
Financial structure sound

Petro-Canada's financial position remains fundamentally sound. Despite the volatile and uncertain business environment, financial coverage and leverage ratios have improved during the past two years. At the end of 1987, the Corporation's measure of debt plus redeemable preferred shares to capital declined to 35.7 per cent from 37.4 per cent at the end of 1986. Cash flow to debt plus redeemable preferred shares rose in 1987 from 33.5 to 37.0 per cent.

The Corporation remains committed to maintaining the integrity of its financial structure. Cash generated from operations continues to be sufficient to finance a significant capital program and fulfil Petro-Canada's fixed financial obligations, including both debt and the servicing of redeemable preferred shares. Dividends of $41 million paid on redeemable preferred shares in 1987 were $18 million lower than in 1986 due to lower prevailing interest rates and share redemptions. Interest expense of $73 million was $6 million higher than in 1986.

Considerable additional external financing will be required if the Corporation is to proceed with major new development projects. Given the uncertain business environment expected over the next few years and the long lead-times typical of major new developments, caution will be required. The financing of new commitments will be carefully planned to avoid undue levels of financial risk and safeguard the Corporation's financial structure.

Cash flow to debt plus redeemable preferred shares
This ratio has averaged 37 per cent during the last five years and demonstrates the Corporation's capability to manage its financial obligations.



*valued at year-end U.S. $/Cdn. $ exchange rates

Petro-Canada Management's Responsibility for the Financial Statements

The financial statements have been prepared by management in accordance with generally accepted accounting principles appropriate in the circumstances. Management is responsible for the other information in the Annual Report, which is consistent, where applicable, with that contained in the financial statements. Management is also responsible for installing and maintaining a system of internal control to provide reasonable assurance that reliable financial information is produced. The Corporation has an internal audit department whose functions include reviewing the system of internal control to ensure that it is adequate and functioning properly.

The Board of Directors is responsible for ensuring that management fulfils its responsibilities for financial reporting and internal control. The Board exercises its responsibilities through the Audit Committee of the Board, a majority of which is composed of directors who are not employees of the Corporation. The committee meets with management, the internal auditors and the external auditors to satisfy itself that responsibilities are properly discharged and to review the financial statements.

The external auditors conduct an independent examination, in accordance with generally accepted auditing standards, and express their opinion on the financial statements. Their examination includes a review and evaluation of the Corporation's system of internal control and appropriate tests and procedures to provide reasonable assurance that the financial statements are presented fairly. The external auditors have full and free access to the Audit Committee of the Board.

Auditors' Report

To the Honourable
Marcel Masse, P.C., M.P.
Minister
Energy, Mines and Resources Canada
House of Commons
Ottawa, Ontario

We have examined the consolidated balance sheet of Petro-Canada (incorporated by Special Act of the Parliament of Canada) as at December 31, 1987 and the related consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1987 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied, except for the change (with which we concur) in the method of accounting for pension plans as explained in Note 14 to the consolidated financial statements, on a basis consistent with that of the preceding year.

We further report that, in our opinion, the transactions of the Corporation and its consolidated wholly owned subsidiaries that have come to our notice in the course of our examination of the consolidated financial statements of Petro-Canada were, in all significant respects, in accordance with the Financial Administration Act and the regulations thereto, the charter and by-laws of the Corporation and its consolidated wholly owned subsidiaries and any directives given to the Corporation.

Calgary, Alberta
February 23, 1988

Arthur Andersen & Co.
Chartered Accountants

Petro-Canada

Consolidated Balance Sheet

As at December 31, 1987
(stated in millions of dollars)

Assets	1987	1986
Current Assets		
Cash and short-term deposits	$ 10	$ —
Accounts receivable	892	874
Inventories (Note 2)	721	553
Income taxes recoverable	4	20
Deposits and prepaid expenses	53	35
	1 680	1 482
Investments (Note 3)	589	356
Property, Plant and Equipment, net (Note 4)	6 197	6 223
Deferred Charges (Note 5)	67	78
	$ 8 453	$ 8 139

Approved on behalf of the Board

Director

Director

Liabilities and Shareholder's Equity	1987	1986
Current Liabilities		
Short-term notes payable	$ 313	$ —
Accounts payable and accrued liabilities	864	933
Current portion of long-term debt	6	13
Outstanding cheques less cash	—	88
	1 183	1 034
Long-term Debt (Note 6)	744	805
Deferred Credits (Note 7)	190	198
Deferred Income Taxes	1 633	1 469
Redeemable Preferred Shares (Note 8)	831	922
Capital (Note 9)	4 161	4 161
Deficit	(289)	(450)
	3 872	3 711
	$ 8 453	$ 8 139

Petro-Canada

Consolidated Statement of Earnings

For the year ended December 31, 1987
(stated in millions of dollars)

	1987	1986
Revenue		
Operating	$ 4 982	$ 5 089
Investment and other income	97	83
	5 079	5 172
Expenses		
Crude oil and product purchases	2 214	2 405
Marketing, general and administrative	819	787
Producing and refining	727	576
Depreciation, depletion and amortization	412	394
Taxes other than income taxes (Note 10)	394	512
Interest on long-term debt	59	36
Other interest	14	31
	4 639	4 741
Earnings before Undernoted Items	440	431
Provision for Income Taxes (Note 11)		
Deferred	164	165
Current	63	84
	227	249
Net Earnings before Dividends on Redeemable Preferred Shares	213	182
Dividends on Redeemable Preferred Shares (Note 8)	41	59
Net Earnings after Dividends on Redeemable Preferred Shares	$ 172	$ 123

Petro-Canada

Consolidated Statement of Retained Earnings

For the year ended December 31, 1987
(stated in millions of dollars)

	1987	1986
Retained Earnings (Deficit) at Beginning of Year	$ (450)	$ (519)
Net earnings before dividends on redeemable preferred shares	213	182
Dividends on redeemable preferred shares	(41)	(59)
Exchange adjustment on redemption of redeemable preferred shares	(11)	(54)
Retained Earnings (Deficit) at End of Year	$ (289)	$ (450)

Petro-Canada

Consolidated Statement of Changes in Financial Position

For the year ended December 31, 1987
(stated in millions of dollars)

	1987	1986
Internally Generated Cash		
Working capital provided from operations (Note 12)	$ 784	$ 728
Proceeds from sale of property, plant and equipment	46	59
Advances on future natural gas deliveries	(11)	(17)
Internally generated cash from operations	819	770
Decrease (increase) in operating working capital (Note 13)	(244)	406
	575	1 176
Investment Activities		
Expenditures on property, plant and equipment	488	614
Petroleum Incentive Program grants	(5)	(166)
Increase in investments, net	142	57
Increase in deferred charges, net	1	24
Acquisition of Gulf Canada Limited assets	—	301
	626	830
Financing Activities and Dividends		
Increase (decrease) in short-term notes payable, net	313	(532)
Redemption of redeemable preferred shares	(102)	(356)
Dividends on redeemable preferred shares	(41)	(59)
Reduction of long-term debt	(21)	(21)
Proceeds from issue of long-term debt	—	556
	149	(412)
Increase (Decrease) in Cash	98	(66)
Cash (Deficiency) at Beginning of Year	(88)	(22)
Cash and Short-Term Deposits (Deficiency) at End of Year	$ 10	$ (88)

Note 1: Summary of Significant Accounting Policies

(a) Basis of Consolidation

The consolidated financial statements include the accounts of Petro-Canada, an agent of Her Majesty in right of Canada, and of all subsidiary companies ("the Corporation") except Canertech Inc., which is excluded for the reason described in Note 3.

The excess of the consideration paid for the shares of subsidiaries over the underlying net book values at the dates of acquisition is attributed to the related assets acquired and is amortized over the life of these assets.

(b) Inventories

Inventories are stated at the lower of cost and net realizable value.

(c) Investments

The Corporation accounts for investments in companies over which it has significant influence on the equity method. Other long-term investments are accounted for on the cost method.

(d) Property, Plant and Equipment

The Corporation accounts for its investment in oil and gas properties on the full cost method whereby all costs relating to the exploration for and development of oil and gas reserves are capitalized. Such costs include those related to lease acquisitions, geological and geophysical activities, lease rentals on non-producing properties, drilling both productive and non-productive wells and overhead related to exploration and development. Separate cost centres have been established for each country in which the Corporation has an interest in oil and gas properties. The Corporation applies a "ceiling test" to each of its producing oil and gas cost centres to ensure that such costs do not exceed the total of the estimated future net revenues from production of proven reserves, the unimpaired costs of certain projects in Canadian frontier areas and the unimpaired costs of unevaluated properties. The estimate of future net revenues is based upon prices and operating costs in effect at the balance sheet date. In addition a consolidated ceiling test provides for future administrative overhead, financing costs and income taxes.

Costs are accumulated separately for the Syncrude Project, producing in situ and other oil sands leases. Overburden removal costs relating to oil sands which will be mined in future years are deferred and are charged to earnings when the related oil sands are mined.

Substantially all of the Corporation's exploration and production activities are conducted jointly with others. Only the Corporation's proportionate interest in such activities is reflected in the financial statements.

The interest cost of debt attributable to the construction of major new facilities is capitalized during the construction period.

(e) Depreciation, Depletion and Amortization

Costs incurred in producing oil and gas cost centres, other than unimpaired costs of certain projects in Canadian frontier areas and of unevaluated properties, and costs incurred on the Syncrude Project and producing in situ oil sands leases are depreciated or depleted separately on the unit of production method based on estimated proven recoverable oil and gas reserves before royalties. For purposes of calculating depreciation and depletion, natural gas production and reserves are converted to equivalent units of crude oil based on the relative energy content of each commodity.

Costs incurred in non-producing oil and gas cost centres and other oil sands leases are subject to review for impairment. Any impairment is charged to earnings. When exploration proves to be successful, and economic viability has been established, the unimpaired balance is depleted on the unit of production method when production commences.

Depreciation of other plant and equipment is provided on either the unit of production method or the straight line method as appropriate. Straight line depreciation rates are based on the estimated service lives of the related assets.

(f) Income Taxes

The Corporation makes full provision for income taxes deferred as the result of claiming depreciation, exploration, development and other costs for income tax purposes which differ from the related amounts charged to earnings.

Note 1: (Continued)

(g) Translation of Foreign Currency

Current assets, except inventories and prepaid expenses, current liabilities and long-term debt are translated at rates of exchange in effect at the balance sheet date. Long-term assets, inventories, prepaid expenses, deferred income taxes and redeemable preferred shares are translated at rates of exchange in effect at the respective transaction dates. Revenue and expense items are translated at the average rates of exchange in effect during the year, except for depreciation, depletion and amortization which reflect rates of exchange in effect when the assets were acquired.

The resulting exchange gains or losses are included in earnings, except for unrealized exchange gains or losses arising on translation of long-term debt, which are deferred and amortized over the remaining term of the debt.

Foreign operations are integrated with the Corporation's other activities and are translated in the manner described above.

Note 2: Inventories

	1987	1986
Crude oil, refined products and merchandise	$ 657	$ 498
Materials and supplies	64	55
	$ 721	$ 553

Note 3: Investments

	1987	1986
At equity		
Westcoast Transmission Company Limited	$ 219	$ 177
Petro-Canada Centre	188	84
Sedpex Inc.	38	31
Other	20	17
At cost		
Mortgages and other investments	44	47
	$ 509	$ 356

Westcoast Transmission Company Limited ("Westcoast")

At December 31, 1987 the Corporation held approximately 31% of the outstanding common shares of Westcoast with a quoted market value of $250 million (1986 – $165 million).

Petro-Canada Centre

At December 31, 1987 the Corporation held 50% of a joint venture which owns Petro-Canada Centre, an office complex in Calgary. The Corporation has entered into a long-term lease for use of a portion of the complex and has guaranteed $133 million of long-term debt related to the facility.

Sedpex Inc.

At December 31, 1987 the Corporation held 50% of the outstanding common shares of Sedpex Inc., a company which owns a semi-submersible drilling vessel. This vessel is under lease to the Corporation.

Canertech Inc. ("Canertech")

The accounts of Canertech, a wholly owned subsidiary company, have been excluded from consolidation because a formal plan exists to dispose of the investment in the subsidiary. In response to a directive by the Government of Canada, the Corporation incorporated Canertech in 1981 to develop alternate energy sources.

At that time the Government indicated its intention of purchasing the Corporation's investment at cost and establishing Canertech as an independent crown corporation. The Corporation is proceeding with the implementation of a Government directive to bring about the dissolution of Canertech. The Corporation's investment in Canertech is carried in the accounts at its original cost of one dollar.

Note 4: Property, Plant and Equipment

	1987			1986	Capital Expenditures	
	Cost	Accumulated Depreciation, Depletion and Amortization	Net	Net	1987	1986
Natural resources						
Oil and gas						
Canada	$ 5 234	$ 1 984	$ 3 250	$ 3 257	$ 239	$ 233
Foreign						
– producing	64	45	19	25	—	1
– non-producing	110	93	17	19	12	13
Oil sands						
Syncrude Project	709	132	577	554	44	48
Producing in situ	130	15	115	91	30	14
Other oil sands	207	207	—	—	5	6
Natural gas liquids	206	78	128	135	2	1
Other	111	82	29	29	4	—
	6 771	2 636	4 135	4 110	336	316
Refined oil products	2 369	448	1 921	1 975	122	112
Other property, plant and equipment	275	134	141	138	25	20
	$ 9 415	$ 3 218	$ 6 197	$ 6 223	$ 483	$ 448

At December 31, 1987, $3 074 million (1986 – $3 103 million) of Canada oil and gas net costs were subject to depreciation and depletion.

Note 5: Deferred Charges

	1987	1986
At cost		
Oil sands overburden removal costs	$ 40	$ 43
Less portion related to oil sands to be mined within one year	16	11
	24	32
Deferred pension funding	13	—
At amortized cost		
Deferred financing costs	14	16
Other	16	19
Translation adjustment on long-term debt	—	11
	$ 67	$ 78

Note 6: Long-Term Debt

	Maturity	1987	1986
In Canadian dollars			
8.25% unsecured notes	1993	$ 11	$ 14
Other		–	1
In United States dollars			
7.25% unsecured debentures (U.S.$200 million)	1996	260	276
8.25% unsecured debentures (U.S.$200 million)	2016	260	276
LIBOR less 0.8% unsecured notes (U.S.$125 million)	1995	162	173
9% unsecured notes (U.S.$30 million)	1995	39	52
7.75% unsecured notes (U.S.$14 million)	1993	18	19
8.45% unsecured notes		—	7
		750	818
Less current portion		6	13
		$ 744	$ 805

Repayment of long-term debt

The minimum repayment of long-term debt in each of the next five years is as follows:
1988 – $ 6 million 1989 – $ 6 million 1990 – $ 6 million 1991 – $ 7 million 1992 – $ 7 million

Note 7: Deferred Credits

	1987	1986
Advances on future natural gas deliveries	$ 118	$ 129
Long-term liabilities	39	69
Translation adjustment on long-term debt	33	—
	$ 190	$ 198

Note 8: Redeemable Preferred Shares

The redeemable preferred shares, which were issued by a subsidiary to a group of Canadian chartered banks, are floating rate, cumulative and non-voting. Cumulative dividends, payable quarterly, are, at the option of the subsidiary, based on a percentage of either the United States Base Rates or the London Inter-Bank Offered Rates of the banks. At December 31, 1987, the dividend rate was approximately 4.4% per annum. The shares are redeemable, at the option of the subsidiary, at one hundred dollars U.S. per share, plus accrued dividends. In 1987 the subsidiary exercised its option to redeem 779 000 shares (1986 – 850 000 shares) for a consideration of U.S.$78 million (1986 – U.S.$85 million). In 1986 the subsidiary repurchased an additional 1 728 000 shares for a consideration of U.S.$172 million. At December 31, 1987, 7 093 000 shares were outstanding.

Subsequent to December 31, 1987 the Corporation gave notice of its intention to redeem the shares by April 11, 1988. The funds for this redemption are to be provided by additional debt.

Note 9: Capital

Authorized

(a) 71 188 common shares with a par value of one hundred thousand dollars each, and

(b) Preferred shares issued to the Government of Canada provided that the amount of such shares together with any loans received, and outstanding, from the Consolidated Revenue Fund of the Government of Canada is not in excess of one billion dollars. These shares have a par value of one dollar each, are redeemable at par at the option of the Corporation, carry no stated rate of dividend and are non-cumulative.

Issued (to the Government of Canada)

	Number of Shares	Consideration
Common Shares		
Balance at beginning and end of year	31 883	$ 3 188
Preferred Shares		
Balance at beginning and end of year	972 771 853	973
Total Capital at Beginning and End of Year		$ 4 161

Note 10: Taxes Other than Income Taxes

	1987	1986
Federal sales tax	$ 349	$ 411
Other	45	63
Petroleum and Gas Revenue Tax	—	38
	$ 394	$ 512

Note 11: Income Taxes

The provision for income taxes of $227 million (1986 – $249 million) represents an effective rate of 51.6% (1986 – 57.8%) on earnings before income taxes of $440 million (1986 – $431 million). The computation of the provision, which requires adjustment to earnings before income taxes for non-taxable and non-allowable items, is as follows:

	1987	1986
Earnings before income taxes	$ 440	$ 431
Add (deduct)		
Royalties and other payments to provincial governments	160	169
Federal allowances		
Resource allowance	(144)	(127)
Tax depletion	(36)	(39)
Petroleum and Gas Revenue Tax	—	38
Non-deductible depreciation, depletion and amortization	99	81
Non-taxable gains	(10)	(21)
Equity in earnings of affiliates	(25)	(18)
Other	(8)	(8)
Earnings as adjusted before income taxes	$ 476	$ 506
Canadian Federal income tax at 46.6% (1986 – 47.8%) applied to earnings as adjusted	$ 222	$ 242
Provincial and other income taxes, net of federal abatement	9	12
Provincial income tax rebates	(4)	(5)
Provision for income taxes	$ 227	$ 249

Note 12: Working Capital Provided from Operations

	1987	1986
Earnings before dividends on redeemable preferred shares	$ 213	$ 182
Add (deduct)		
Depreciation, depletion and amortization	412	394
Deferred income taxes	164	165
Equity earnings, net of dividends received	(4)	—
Other	(1)	(13)
	$ 784	$ 728

Note 13: Increase (Decrease) in Components of Operating Working Capital

	1987	1986
Accounts receivable	$ 18	$ (433)
Inventories	168	(557)
Income taxes recoverable	(16)	10
Deposits and prepaid expenses	18	2
Accounts payable and accrued liabilities	69	556
Other	(13)	16
	$ 244	$ (406)

Operating working capital is comprised of working capital other than cash and short-term deposits, short-term notes payable and current portion of long-term debt.

Note 14: Pension Plans

Effective January 1, 1987 the Corporation adopted prospectively the Canadian Institute of Chartered Accountants' new recommendations on accounting for pension costs and obligations. Prior to 1987 the Corporation charged to earnings an amount equal to that funded. The effect of this change was to increase 1987 net earnings by $6 million.

The Corporation's plans are defined benefit plans with the benefits generally based upon years of service and average salary during the final years of employment. They are funded by the Corporation based upon the advice of an independent actuary.

Plan Status as at December 31	1987	1986
Actuarial value of assets	$ 394	$ 351
Pension obligation	382	352
Net pension asset (obligation)	$ 12	$ (1)

The net pension asset (obligation) is amortized to earnings over the expected average remaining service life of the employees covered by the plans, which is currently 12 years.

1987 pension funding and expense amounted to $32 million and $17 million respectively.

Note 15: Related Party Transactions

Transactions with the Government of Canada and its agencies are in the normal course of business and are therefore on the same terms as those accorded to non-related parties.

Note 16: Segmented Information

The Corporation operates in two business segments:

Natural resources, comprising: exploration, development, production, transportation and marketing activities for crude oil, natural gas, field liquids, sulphur and oil sands; and extraction of liquids from natural gas.

Refined oil products, comprising: purchase and sale of crude oil; refining crude oil into oil products; and distribution and marketing of these and other purchased products.

Financial information by business segment is presented in the following table as though each segment were a separate business entity. Inter-segment transfers of products, which are accounted for at market value, are eliminated on consolidation. Corporate and other includes investment income, interest expense and unallocated general corporate revenues and expenditures. Corporate and other assets are principally cash and short-term deposits, investments in other companies and general corporate assets.

	Natural Resources		Refined Oil Products		Corporate and Other		Consolidated	
	[illegible]	1986	[illegible]	1986	[illegible]	1986	[illegible]	1986
Revenue								
Sales to customers and other revenues	[illegible]	$ 546	[illegible]	$ 4 588	[illegible]	$ 38	[illegible]	$ 5 172
Inter-segment sales	[illegible]	534		—		—		
Segment Revenue	[illegible]	$ 1 080	[illegible]	$ 4 588	[illegible]	$ 38		
Earnings								
Operating earnings before depreciation, depletion and amortization	[illegible]	$ 470	[illegible]	$ 365	[illegible]	$ 57	[illegible]	$ 892
Depreciation, depletion and amortization	[illegible]	(245)	[illegible]	(141)	[illegible]	(8)	[illegible]	(394)
Interest	[illegible]	—		—	[illegible]	(67)	[illegible]	(67)
Provision for income taxes	[illegible]	(168)	[illegible]	(109)	[illegible]	28	[illegible]	(249)
Net Earnings (Loss) Before Dividends on Redeemable Preferred Shares	[illegible]	$ 57	[illegible]	$ 115	[illegible]	$ 10	[illegible]	$ 182
Capital Expenditures								
Capital expenditures on property, plant and equipment, deferred charges and investments	[illegible]	$ 319	[illegible]	$ 118	[illegible]	$ 92	[illegible]	$ 529
Acquisitions including minority interests		—		301		—		301
	[illegible]	$ 319	[illegible]	$ 419	[illegible]	$ 92	[illegible]	$ 830
Total Assets	[illegible]	$ 4 392	[illegible]	$ 3 222	[illegible]	$ 525	[illegible]	$ 8 139
Capital Employed	[illegible]	$ 4 102	[illegible]	$ 2 698	[illegible]	$ 318	[illegible]	$ 7 118

Note 17: Comparative Figures

Certain reclassifications have been made to the 1986 comparative figures to conform with the current year's presentation.

Note 18: Commitments and Contingencies

(a) Commitments

The Corporation has leased property and equipment under various long-term operating leases for periods up to 2008. The minimum annual rentals for non-cancellable operating leases are estimated at $73 million in 1988, $49 million in 1989, $49 million in 1990, $40 million in 1991, $36 million in 1992 and $17 million per year thereafter until 2008.

(b) Contingencies

The Corporation is involved in litigation and claims associated with normal operations. Management is of the opinion that any resulting settlements would not materially affect the financial position of the Corporation.

Glossary of Financial Terms

Capital employed	Total assets less current liabilities excluding short-term notes payable and the current portion of long-term debt. Average capital employed is the average of the current year's and previous year's capital employed balances measured at year end.
Cash flow return on average capital employed	Working capital provided from operations as disclosed in the financial statements plus tax adjusted interest expense plus investment tax credits divided by average capital employed.
Cash flow to debt plus redeemable preferred shares	Cash generated from operations divided by long-term debt including the current portion of long-term debt, short-term notes payable, outstanding cheques less cash, advances on future natural gas deliveries and redeemable preferred shares valued at year-end U.S. $/Cdn. $ exchange rates.
Cash generated from operations	Internally generated cash from operations as disclosed in the financial statements less dividends on redeemable preferred shares.
Debt plus redeemable preferred shares to capital	Long-term debt including the current portion of long-term debt, short-term notes payable, outstanding cheques less cash, advances on future natural gas deliveries and redeemable preferred shares divided by shareholder's equity plus total debt obligations (as defined above) and redeemable preferred shares. Redeemable preferred shares are valued at year-end U.S. $/Cdn. $ exchange rates; retained earnings also reflect this valuation.
Gross capital expenditures	Total expenditures on property, plant and equipment.
Net capital expenditures	Expenditures on property, plant and equipment less Petroleum Incentive Program grants.
Reinvestment ratio	Net capital expenditures divided by cash generated from operations.
Return on average capital employed	Earnings before unusual items and dividends on redeemable preferred shares plus tax adjusted interest expense divided by average capital employed.
Return on average shareholder's equity	Earnings before unusual items and after dividends on redeemable preferred shares divided by average shareholder's equity. Average shareholder's equity reflects the valuation of redeemable preferred shares at year-end U.S.$/ Cdn. $ exchange rates.

Petro-Canada

Reserves Information

(proven reserves, net after royalties)

	1987			1986		
	Developed	Undeveloped	Total	Developed	Undeveloped	Total
Crude oil and natural gas liquids (thousands of m³)						
Conventional crude oil	27 373	2 097	29 470	27 863	2 245	30 108
Synthetic crude oil	29 865	3 906	33 771	29 401	3 906	33 307
Bitumen	1 265	3 399	4 664	1 227	3 399	4 626
Natural gas liquids	4 447	977	5 424	4 371	892	5 263
Total	62 950	10 379	73 329	62 862	10 442	73 304
Natural gas (millions of m³)	57 873	20 350	78 223	57 813	19 510	77 323

	1987			1986		
	Oil (thousands of m³)	NGL (thousands of m³)	Gas (millions of m³)	Oil (thousands of m³)	NGL (thousands of m³)	Gas (millions of m³)
Balance, beginning of year	68 041	5 263	77 323	66 862	5 494	77 862
Revisions of previous estimates	3 678	741	4 142	5 350	326	1 950
Extension and discoveries	637	—	386	199	—	486
Production	(4 451)	(580)	(3 628)	(4 370)	(557)	(2 975)
Balance, end of year	67 905	5 424	78 223	68 041	5 263	77 323

Notes:

1. Reserves quantities in the Annual Report, excluding synthetic crude oil, are reported based on estimates consistent with the knowledge of the characteristics and extent of underlying productive formations at each year end.
2. The above figures include Petro-Canada's 17% interest in the synthetic crude oil reserves of Syncrude. These reserves are based on the demonstrated production capacity of the Syncrude plant and an estimate of the incremental production attributable to the capital program scheduled for completion in 1988, both calculated over the remaining term of the current operating permit to the year 2013.
The Syncrude project is subject to a royalty agreement between the Province of Alberta and the Syncrude participants whereby the Province has the right to 50% of Syncrude's deemed net profit. The Province has an option to convert its royalty to a 7.5% gross overriding royalty.
The net after royalty reserves of Syncrude are based on an estimated average royalty rate for the life of the project using current prices and operating costs.

Petro-Canada

Five Year Financial Summary

(stated in millions of dollars)

	1987	1986	1985	1984	1983
Summary of Earnings					
Revenue	$ 5 079	$ 5 172	$ 5 381	$ 4 988	$ 4 171
Expenses	4 639	4 741	4 868	4 376	3 797
	440	431	513	612	374
Add (deduct)					
Provision for income taxes	(227)	(249)	(341)	(385)	(268)
Minority interest	—	—	2	5	6
Earnings before unusual and extraordinary items and dividends on redeemable preferred shares	213	182	174	232	112
Unusual items	—	—	865	—	—
Extraordinary items	—	—	—	—	17
Net earnings (loss) before dividends on redeemable preferred shares	213	182	(691)	232	95
Dividends on redeemable preferred shares	41	59	78	100	86
Net earnings (loss) after dividends on redeemable preferred shares	$ 172	$ 123	$ (769)	$ 132	$ 9
Other Financial Data					
Cash generated from operations	$ 778	$ 711	$ 828	$ 868	$ 622
Expenditures on property, plant and equipment	488	614	1 059	1 131	997
Petroleum Incentive Program grants	5	166	349	380	469
Acquisitions including minority interests	—	301	1 010	(2)	530
Total assets	8 453	8 139	8 846	8 966	8 194
Average capital employed	7 353	7 226	7 746	7 780	7 132
Working capital	497	448	397	905	809
Long-term debt (Note 3)	750	818	289	157	188
Redeemable preferred shares	831	922	1 224	1 312	1 394
Shareholder's equity	3 872	3 711	3 642	4 478	3 932
Annual Operating Revenues					
Resources Division					
Crude oil and natural gas liquids					
Conventional crude oil	$ 413	$ 336	$ 613	$ 585	$ 523
Synthetic crude oil	192	167	279	214	225
Bitumen	19	13	14	—	—
Field natural gas liquids	57	50	80	67	59
	681	566	986	866	807
Natural gas	203	219	292	284	238
Sulphur	25	31	34	27	19
Natural gas liquids from straddle plants	145	192	235	246	239
Other	84	72	89	116	88
Total	$ 1 138	$ 1 080	$ 1 636	$ 1 539	$ 1 391

	1987	1986	1985	1984	1983
Annual Operating Revenues (Continued)					
Products Division					
Gasolines	$ 2 240	$ 2 280	$ 2 232	$ 1 814	$ 1 545
Distillates	1 384	1 549	1 350	1 025	873
Other including petrochemicals	837	759	768	592	531
Total	$ 4 461	$ 4 588	$ 4 350	$ 3 431	$ 2 949
Expenditures on Property, Plant and Equipment					
Resources Division					
Exploration					
Frontier	$ 41	$ 245	$ 442	$ 601	$ 581
Western provinces	101	62	145	128	123
Foreign	12	11	19	30	6
Development					
Western provinces	108	99	166	104	127
Foreign	—	1	6	6	—
Oil Sands					
Syncrude	44	47	60	31	22
Other	35	17	30	53	5
	341	482	868	953	864
Products Division					
Refining	49	55	115	90	49
Marketing	73	57	50	33	49
	122	112	165	123	98
Support facilities	25	20	26	55	35
	488	614	1 059	1 131	997
Petroleum Incentive Program grants	5	166	349	380	469
Total	$ 483	$ 448	$ 710	$ 751	$ 528
Reinvestment ratio	0.62	0.63	0.86	0.87	0.85
Financial Indicators (per cent)					
Performance					
Return on average capital employed	3.4	3.0	2.4	3.1	1.8
Cash flow return on average capital employed	11.3	10.7	11.7	11.9	9.5
Return on average shareholder's equity	4.7	3.5	2.5	3.2	0.7
Leverage					
Debt plus redeemable preferred shares to capital	35.7	37.4	41.8	29.6	32.2
Cash flow to debt plus redeemable preferred shares	37.0	33.5	33.8	48.0	34.1

Notes:

1. Financial and operating results are included from March 1, 1983, for the former BP Refining and Marketing Canada Limited operations, and from October 1, 1985, for the operations of the assets aquired from Gulf Canada Limited except for the Edmonton refinery, and from April 1, 1986 for the operations of the former Gulf Canada Limited Edmonton refinery.
2. Certain reclassifications have been made to the figures previously reported to reflect subsequent changes in reporting presentation.
3. Long-term debt includes current maturities.

Petro-Canada

Five Year Operating Summary

	1987	1986	1985	1984	1983
Oil and Gas Landholdings (gross/net) (millions of hectares)					
Canadian provinces					
Alberta – Oil and natural gas rights	2.2/1.1	2.3/1.1	2.6/1.2	3.0/1.4	3.1/1.6
– Oil sands rights	1.0/0.4	1.1/0.4	1.0/0.4	0.9/0.3	0.9/0.3
British Columbia	0.9/0.5	1.1/0.6	1.4/0.7	1.3/0.7	1.3/0.7
Saskatchewan	0.2/0.1	0.2/0.2	0.2/0.1	0.2/0.1	0.3/0.1
Other provinces	0.1/0.1	0.1/0.1	0.2/0.1	0.3/0.2	1.3/0.7
	4.4/2.2	4.8/2.4	5.4/2.5	5.7/2.7	6.9/3.4
Frontier Canada	8.0/5.4	14.2/8.0	33.2/16.5	41.6/20.5	54.4/25.0
International	1.3/0.7	1.2/0.5	3.4/1.1	2.8/0.4	1.7/0.1
Total	13.7/8.3	20.2/10.9	42.0/20.1	50.1/23.6	63.0/28.5
Wells Drilled (gross/net)					
Non-frontier areas – exploratory wells					
Oil	20/11	21/13	42/30	65/45	41/30
Gas	10/6	34/15	50/27	25/11	24/16
Dry	35/25	42/24	75/53	74/47	68/48
	65/42	97/52	167/110	164/103	133/94
Non-frontier areas – development wells					
Oil	199/74	283/51	482/169	344/134	148/84
Gas	45/27	32/10	47/26	16/6	17/12
Oil sands	75/38	4/2	—/—	193/96	27/13
Dry	20/13	14/7	48/21	24/10	9/5
	339/152	333/70	577/216	577/246	201/114
Frontier and international – exploratory and development wells					
Oil	3/1	9/2	16/4	9/2	5/1
Gas	—/—	9/3	10/4	9/2	6/2
Dry	6/2	19/6	26/7	25/8	14/5
	9/3	37/11	52/15	43/12	25/8
Total	413/197	467/133	796/341	784/361	359/216
Proven Reserves (net, before royalties/after royalties)					
Natural gas (billions of m^3)	96.9/78.2	96.7/77.3	98.8/77.9	120.4/100.4	134.3/108.8
Sulphur (millions of tonnes)	5.4/4.6	5.2/4.4	5.5/4.6	4.8/4.0	5.6/4.7
Crude oil and natural gas liquids (millions of m^3)					
Conventional crude oil	37.2/29.5	38.9/30.1	41.3/30.4	48.1/34.3	45.9/33.3
Synthetic crude oil	39.7/33.8	39.2/33.3	39.1/33.2	25.4/21.6	26.3/22.3
Bitumen	4.9/4.6	4.9/4.6	4.5/4.3	1.1/1.0	—/—
Natural gas liquids	7.2/5.4	7.1/5.3	7.5/5.5	6.4/4.7	7.4/5.1
Total	89.0/73.3	90.1/73.3	92.4/73.4	81.0/61.6	79.6/60.7

	1987	1986	1985	1984	1983
Daily Production					
(net, before royalties/after royalties)					
Natural gas (millions of m³)	12.3/9.9	10.2/8.2	11.6/9.1	10.8/9.0	10.0/8.1
Sulphur (thousands of tonnes)	1.0/0.8	0.9/0.8	0.9/0.8	1.4/1.2	1.1/0.9
Crude oil and natural gas liquids (thousands of m³)					
Conventional crude oil	10.1/8.1	10.1/8.0	10.1/7.7	10.7/7.8	9.8/7.2
Synthetic crude oil	3.7/3.6	3.5/3.4	3.5/3.1	2.3/2.1	3.0/2.4
Bitumen	0.5/0.5	0.6/0.6	0.2/0.2	—/—	—/—
Field natural gas liquids	2.1/1.6	2.1/1.5	1.8/1.3	1.5/1.1	1.5/1.0
Total	16.4/13.8	16.3/13.5	15.6/12.3	14.5/11.0	14.3/10.6
Natural gas liquids production from straddle plants including ethane (thousands of m³)	6.3	6.5	5.7	6.3	6.1
Average sale prices					
Crude oil and field natural gas liquids ($ per m³)	140	115	227	213	204
Natural gas ($ per thousand m³)	57	75	87	88	85
Marketing					
Retail and wholesale marketing outlets	4 268	4 344	4 620	2 716	3 107
Petroleum product sales (thousands of m³ per day)					
Gasolines	20.3	20.3	16.3	13.9	12.9
Distillates	16.7	16.2	12.2	9.6	8.7
Other including petrochemicals	8.6	7.9	7.0	6.3	5.5
Total	45.6	44.4	35.5	29.8	27.1
Refining					
Refinery crude capacity (thousands of m³ per day)	64.0	64.0	46.2	31.6	31.6
Crude oil processed by Petro-Canada (thousands of m³ per day)	48.4	47.2	34.2	27.6	25.3
Refinery utilization (per cent)	76	74	78	86	78
Employees					
Number at year end	7 204	7 740	9 747	6 798	6 272

Notes:

1. Certain reclassifications have been made to the figures previously reported to reflect subsequent changes in reporting presentations.
2. Operating results are included from March 1, 1983, for the former BP Refining and Marketing Canada Limited operations, from October 1, 1985, for the operations of the assets acquired from Gulf Canada Limited except for the Edmonton refinery, and from April 1, 1986, for the operations of the former Gulf Canada Limited Edmonton refinery.

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